

2007

a n n u a l r e p o r t



Dillard's  
The Style of Your Life.

We experienced a challenging year at Dillard's in 2007. Following a record-breaking performance in 2006, we were optimistic that we would deliver continued notable improvement in 2007. We simply did not achieve the level of sales necessary to make that happen. We did, however, underscore our commitment to our shareholders during the year by repurchasing \$111.6 million of Class A Common Stock and closing nine under-performing stores. At the same time, we worked to maintain appropriate control over inventory levels and expenses, as the year progressed with increasingly sluggish macroeconomic conditions.

It is relatively easy for a retailer to cite challenging macroeconomic factors in a time of poor operational performance. The more difficult task lies in self-assessment and in moving forward with a clear vision for improvement. At Dillard's, we must be great at what we do in all circumstances.

Moving ahead, we will work to set Dillard's apart in the marketplace by executing further improvements to our merchandise mix. We believe strengthening our appeal to aspirational and contemporary shoppers will redefine Dillard's as a revered national brand with a completely new attitude. Accordingly, we will seek to build and nurture solid relationships with vendors who offer upscale, highly regarded product while working to find that next hot brand. We will support this endeavor with our 'Dillard's – The Style of Your Life.' branding campaign to share the fashion excitement and educate consumers about the bold new look of Dillard's.

Additionally, we will work to respond faster to replenishing top-selling product, while utilizing our information systems and distribution network to better match in-stock merchandise with high demand location by location.

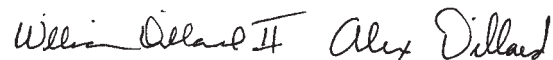
Clearly, at Dillard's, our success lies primarily in effective execution of our merchandising initiatives. However, we must improve our financial position, as well, by taking appropriate steps with under-performing stores and facilities as we did in 2007. To date in 2008, we have announced six such store closures. We will continue to evaluate our store base in 2008, aggressively addressing under-performing stores and facilities where appropriate.

We completed our \$200 million share repurchase program in the fall of 2007 with the purchase of \$111.6 million of Class A Common Stock. Immediately, our board of directors approved another \$200 million authorization. In 2008, we will actively seek out opportunities to repurchase shares as conditions permit.

Regardless of the changes and challenges around us, our mission remains to provide each and every person who visits Dillard's the best customer care anywhere. Our customers demand a compelling assortment of fashion complemented by exceptional customer service and presented in an attractive store. Accordingly, in 2007 we opened nine new stores in some of the nation's most vibrant communities and in exciting centers where customers live, work and shop. To date in 2008, we have opened five such locations with four on the horizon for the fall. We were also very pleased to have recently opened a brand new store in Biloxi, Mississippi replacing a store that was devastated by Hurricane Katrina in 2005.

In early 2008, we reached our 70th year anniversary of serving America's communities with inspiring fashion and extraordinary value. Reflection and celebration of this legacy is impossible without thanking our shareholders and associates for their noteworthy contributions to this effort. We look forward to a productive and rewarding 2008 for all.

Regards,



William Dillard, II  
Chairman of the Board  
& Chief Executive Officer

Alex Dillard  
President

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended February 2, 2008**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from**                      **to**                      **.**

**Commission file number 1-6140**

**DILLARD'S, INC.**

(Exact name of registrant as specified in its charter)

**DELAWARE**  
(State or other jurisdiction  
of incorporation or organization)

**71-0388071**  
(IRS Employer  
Identification Number)

**1600 CANTRELL ROAD, LITTLE ROCK, ARKANSAS 72201**

(Address of principal executive office)

(Zip Code)

**(501) 376-5200**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

**Title of each Class**  
**Class A Common Stock**

**Name of each exchange on which registered**  
**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (See definition of "accelerated filer and large accelerated filer" in Exchange Act Rule 12b-2).

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Exchange Act Rule 12-b-2). Yes  No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant as of August 4, 2007: \$1,868,526,448.

Indicate the number of shares outstanding of each of the Registrant's classes of common stock as of March 1, 2008:

CLASS A COMMON STOCK, \$0.01 par value .....	71,155,347
CLASS B COMMON STOCK, \$0.01 par value .....	4,010,929

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held May 17, 2008 (the "Proxy Statement") are incorporated by reference into Part III.



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## PART I

### ITEM 1. BUSINESS.

#### General

Dillard's, Inc. (the "Company", "we", "us", "our" or "Registrant") ranks among the nation's largest apparel and home furnishing retailers. Our Company, originally founded in 1938 by William T. Dillard, was incorporated in Delaware in 1964. As of February 2, 2008, we operated 326 Dillard's stores offering a wide selection of merchandise including fashion apparel for women, men and children, accessories, cosmetics, home furnishings and other consumer goods. The following table summarizes the percentage of net sales by each major product line:

	Percentage of Net Sales		
	Fiscal 2007	Fiscal 2006	Fiscal 2005
Cosmetics .....	15%	15%	15%
Ladies' Apparel and Accessories .....	37	36	36
Juniors' and Children's Apparel .....	9	10	10
Men's Apparel and Accessories .....	18	18	18
Shoes .....	13	13	12
Home and Other .....	8	8	9
Total .....	100%	100%	100%

Our store base is diversified, with the character and culture of the community served determining the size of facility and, to a large extent, the merchandise mix presented. Most stores are located in suburban shopping malls. Our customers may also purchase merchandise on-line at our website, [www.dillards.com](http://www.dillards.com), which features on-line gift registries and a variety of other services. We operate retail department stores located primarily in the southwest, southeast and midwest regions of the United States. The stores are located in 29 states, with 53 stores located in the western region, 123 stores in the eastern region and 150 stores in the central region.

We conduct our retail merchandise business under highly competitive conditions. Although we are a large regional department store, we have numerous competitors at the national and local level that compete with our individual stores, including specialty, off-price, discount, internet, and mail-order retailers. Competition is characterized by many factors including location, reputation, assortment, advertising, price, quality, service and credit availability. We believe that our stores are in a strong competitive position with regard to each of these factors. In an effort to strengthen this position, we will continue to make notable changes to our merchandise mix, positioning our stores toward a more upscale and contemporary tone to attract new customers who are seeking exciting statements in fashion. At the same time, we will work to maintain valued relationships with our existing loyal customer base by continuing to provide updated fashion choices, dependable quality, reliable service and measurable value. Our expanded selections of more upscale and contemporary choices include, but are not limited to, Dillard's improved lines of exclusive brand merchandise such as Antonio Melani, Gianni Bini, Roundtree & Yorke and Daniel Cremieux. Other retailers may compete for customers on some or all of these factors, or on other factors, and may be perceived by some potential customers as being better aligned with their particular preferences. The Company's earnings depend to a significant extent on the results of operations for the last quarter of its fiscal year. Due to holiday buying patterns, sales for that period average approximately one-third of annual sales.

We purchase merchandise from many suppliers, none of which accounted for more than 5% of our net purchases during 2007. We have no long-term purchase commitments or arrangements with any of our suppliers, and we do not believe we are dependent on any one supplier. We consider our relationships with our suppliers to be strong and mutually beneficial.

Our merchandising, sales promotion, and store operating support functions are conducted in multiple locations. Our back office sales support functions for the Company, such as accounting, product development, store planning and information technology, are centralized.

We have developed a knowledge of each of our trade areas and customer bases for our stores. This knowledge is gained through our regional merchandising structure in conjunction with store visits by senior management and merchandising personnel complemented by the use of on-line merchandise information. We will continue to use existing technology and research to edit assortments by store to meet the specific preference, taste and size requirements of each local operating area.

Certain departments in our stores are licensed to independent companies in order to provide high quality service and merchandise where specialization, focus and expertise are critical. The licensed departments vary by store to complement our own merchandising departments. The principal licensed departments are fine jewelry and an upscale women's apparel vendor in certain stores. The terms of the license agreements typically range between three and five years with one year renewals and require the licensee to pay for fixtures and provide its own employees. We regularly evaluate the performance of the licensed departments and require compliance with established customer service guidelines.

In November 2004, the Company sold substantially all of the assets of its Dillard's proprietary credit card ("proprietary card") business to GE Consumer Finance ("GE"). These assets included the proprietary card account balances owned by the Dillard's Credit Card Master Trust, which previously owned and securitized the accounts receivable generated by the proprietary card accounts.

As a result of the transaction and pursuant to a long-term marketing and servicing alliance with an initial term of ten years, GE establishes and owns proprietary card accounts for our customers, retains the benefits and risks associated with the ownership of the accounts, provides key customer service functions, including new account openings, transaction authorization, billing adjustments and customer inquiries, receives the finance charge income and incurs the bad debts associated with those accounts. Pursuant to the long-term marketing and servicing alliance, we receive on-going cash compensation from GE based upon the portfolio earnings. With the sale, we became a more focused retailer and used the proceeds generated from the sale and ongoing compensation to strengthen our balance sheet and return value to our shareholders. Further pursuant to this agreement, we have no continuing involvement other than to honor the proprietary cards in our stores. Although not obligated to a specific level of marketing commitment, we participate in the marketing of the proprietary cards and accept payments on the proprietary cards in our stores as a convenience to customers who prefer to pay in person rather than by mailing their payments to GE.

We seek to expand the number and use of the proprietary cards by, among other things, providing incentives to sales associates to open new credit accounts, which generally can be opened while a customer is visiting one of our stores. Customers who open accounts are rewarded with certificates for discounts on later purchases. Proprietary card customers are sometimes offered private shopping nights, direct mail catalogs, special discounts, and advance notice of sale events. GE has created various loyalty programs that reward customers for frequency and volume of proprietary card usage.

Our fiscal year ends on the Saturday nearest January 31 of each year. Fiscal years 2007, 2006 and 2005 ended on February 2, 2008, February 3, 2007 and January 28, 2006, respectively. Fiscal year 2006 included 53 weeks, and fiscal years 2007 and 2005 included 52 weeks.

For additional information with respect to our business, reference is made to information contained under the headings "Net sales," "Net income," "Total assets" and "Number of employees-average," under item 6 hereof.

The information contained on our website is not incorporated by reference into this Form 10-K and should not be considered to be a part of this Form 10-K. Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, statements of changes in beneficial ownership of securities on Form 4 and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are available free of charge (as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC) on the Dillard's, Inc. website:

**[www.dillards.com](http://www.dillards.com)**



We have adopted a Code of Business Conduct and Corporate Governance Guidelines, as required by the listing standards of the New York Stock Exchange and the rules of the SEC. We have posted on our website our Code of Conduct, Corporate Governance Guidelines, Social Accountability Policy and committee charters for the Audit Committee of the Board of Directors and the Stock Option and Executive Compensation Committee.

Our corporate offices are located at 1600 Cantrell Road, Little Rock, Arkansas 72201, telephone: 501-376-5200.

#### **ITEM 1A. RISK FACTORS.**

The risks described in Item 1A, Risk Factors, in this Annual Report on Form 10-K for the year ended February 2, 2008, could materially and adversely affect our business, financial condition and results of operations. The risk factors discussed below do not identify all risks that we face because our business operations could also be affected by additional factors that are not presently known to us or that we currently consider to be immaterial to our operations.

The Company cautions that forward-looking statements, as such term is defined in the Private Securities Litigation Reform Act of 1995, contained in this Annual Report on Form 10-K are based on estimates, projections, beliefs and assumptions of management at the time of such statements and are not guarantees of future performance. The Company disclaims any obligation to update or revise any forward-looking statements based on the occurrence of future events, the receipt of new information, or otherwise. Forward-looking statements of the Company involve risks and uncertainties and are subject to change based on various important factors. Actual future performance, outcomes and results may differ materially from those expressed in forward-looking statements made by the Company and its management as a result of a number of risks, uncertainties and assumptions.

#### ***The retail merchandise business is highly competitive, and that competition could lower revenues, margins and market share.***

We conduct our retail merchandise business under highly competitive conditions. Although we are a large regional department store, we have numerous competitors at the national and local level that compete with our individual stores, including specialty, off-price, discount, internet and mail-order retailers. Competition is characterized by many factors including location, reputation, fashion, merchandise assortment, advertising, price, quality, service and credit availability. We anticipate intense competition will continue to focus on pricing. Some of our competitors have substantially larger marketing budgets, which may provide them with a competitive advantage. If we are unable to maintain our competitive position, we could experience downward pressure on prices, lower demand for products, reduced margins, the inability to take advantage of new business opportunities and the loss of market share.

#### ***Changes in economic, market and other conditions could adversely affect our operating results.***

The retail merchandise business is affected by changes in international, national, regional, and local economic conditions, consumer preferences and spending patterns, demographic trends, consumer confidence, consumer credit availability, weather, traffic patterns, the type, number and location of competing stores, and the effects of war or terrorist activities and any governmental responses thereto. Factors such as inflation, apparel costs, labor and benefit costs, legal claims, and the availability of management and hourly employees also affect store operations and administrative expenses. Our ability to finance new store development, improvements and additions to existing stores, and the acquisition of stores from competitors is affected by economic conditions, including interest rates and other government policies impacting land and construction costs and the availability of borrowed funds.

***Current store locations may become less desirable, and desirable new locations may not be available for a reasonable price, if at all.***

The success of any store depends substantially upon its location. There can be no assurance that current locations will continue to be desirable as demographic patterns change. Neighborhood or economic conditions where stores are located could decline in the future, thus resulting in potentially reduced sales in those locations. If we cannot obtain desirable locations at reasonable prices our cost structure will increase and our revenues will be adversely affected.

***Ownership and leasing of significant amounts of real estate exposes us to possible liabilities and losses.***

We own the land and building, or lease the land and/or the building, for all of our stores. Accordingly, we are subject to all of the risks associated with owning and leasing real estate. In particular, the value of the assets could decrease, and their costs could increase, because of changes in the investment climate for real estate, demographic trends and supply or demand for the use of the store, which may result from competition from similar stores in the area, as well as liability for environmental conditions. We generally cannot cancel these leases. If an existing or future store is not profitable, and we decide to close it, we may be committed to perform certain obligations under the applicable lease including, among other things, paying the base rent for the balance of the lease term. In addition, as each of the leases expires, we may be unable to negotiate renewals, either on commercially acceptable terms or at all, which could cause us to close stores in desirable locations. If an existing owned store is not profitable, and we decide to close it, we may be required to record an impairment charge and/or exit costs associated with the disposal of the store. We may not be able to close an unprofitable owned store due to an existing operating covenant which may cause us to operate the location at a loss and prevent us from finding a more desirable location. We have approximately 95 stores along the Gulf and Atlantic coasts that are not covered by third party insurance but are self-insured for property and merchandise losses related to “named storms”; therefore, repair and replacement costs will be borne by us for damage to any of these stores from “named storms”.

***We rely on third party suppliers to obtain materials and provide production facilities from which we source our merchandise.***

We may experience supply problems such as unfavorable pricing or untimely delivery of merchandise. The price and availability of materials from suppliers can be adversely affected by factors outside of our control such as increased worldwide demand. Further, our suppliers who also serve the retail industry may experience financial difficulties due to a downturn in the industry. These supplier risks may have a material adverse effect on our business and results of operations.

***We intend to evaluate acquisitions, joint ventures and other strategic initiatives, any of which could distract management or otherwise have a negative effect on revenues, costs and stock price.***

Our future success may depend on opportunities to buy or obtain rights to other businesses or technologies that could complement, enhance or expand our current business or products or that might otherwise offer growth opportunities. In particular, we intend to evaluate potential mergers, acquisitions, joint venture investments, strategic initiatives, alliances, vertical integration opportunities and divestitures. Our attempt to engage in these transactions may expose us to various inherent risks, including:

- assessing the value, future growth potential, strengths, weaknesses, contingent and other liabilities and potential profitability of acquisition candidates;
- the potential loss of key personnel of an acquired business;
- the ability to achieve projected economic and operating synergies;
- difficulties successfully integrating, operating, maintaining and managing newly acquired operations or employees;

- difficulties maintaining uniform standards, controls, procedures and policies;
- unanticipated changes in business and economic conditions affecting an acquired business;
- the possibility of impairment charges if an acquired business performs below expectations; and
- the diversion of management's attention from the existing business to integrate the operations and personnel of the acquired or combined business or to implement the strategic initiative.

***Our annual and quarterly financial results may fluctuate depending on various factors, many of which are beyond our control, and if we fail to meet the expectations of securities analysts or investors, our share price may decline.***

Our sales and operating results can vary from quarter to quarter and year to year depending on various factors, many of which are beyond our control. Certain events and factors may directly and immediately decrease demand for our products. If customer demand decreases rapidly, our results of operations would also decline precipitously. These events and factors include:

- variations in the timing and volume of our sales;
- sales promotions by us or our competitors;
- changes in average same-store sales and customer visits;
- variations in the price, availability and shipping costs of supplies;
- seasonal effects on demand for our products;
- changes in competitive and economic conditions generally;
- changes in the cost or availability of material or labor; and
- weather and acts of God.

***Litigation from customers, employees and others could harm our reputation and impact operating results.***

Class action lawsuits have been filed, and may continue to be filed, from customers alleging discrimination. We are also susceptible to claims filed by customers alleging responsibility for injury suffered during a visit to a store. Further, we may be subject to other claims in the future based on, among other things, employee discrimination, harassment, wrongful termination and wage issues, including those relating to overtime compensation. These types of claims, as well as other types of lawsuits to which we are subject to from time to time, can distract management's attention from core business operations and/or negatively impact operating results.

***Catastrophic events may disrupt our business.***

Unforeseen events, including war, terrorism and other international conflicts, public health issues, and natural disasters such as earthquakes, hurricanes or other adverse weather and climate conditions, whether occurring in the United States or abroad, could disrupt our operations, disrupt international trade and supply chain efficiencies, suppliers or customers, or result in political or economic instability. These events could result in property losses, reduce demand for our products or make it difficult or impossible to receive products from suppliers.

***Variations in the amount of vendor advertising allowances received could adversely impact our operating results.***

We receive vendor advertising allowances that are a strategic part of our advertising program. If vendor advertising allowances were substantially reduced or eliminated, we would likely consider other methods of advertising as well as the volume and frequency of our product advertising, which could increase/decrease our expenditures and/or revenue.

*If we do not maintain the security of customer-related information, we could damage our reputation with customers, incur substantial additional costs and become subject to litigation.*

As do most retailers, we receive certain personal information about our customers. In addition, our online operations at [www.dillards.com](http://www.dillards.com) depend upon the secure transmission of confidential information over public networks, including information permitting cashless payments. A compromise of our security systems that results in customer personal information being obtained by unauthorized persons could adversely affect our reputation with our customers and others, as well as our operations, results of operations, financial condition and liquidity, and could result in litigation against us or the imposition of penalties. In addition, a security breach could require that we expend significant additional resources related to our information security systems and could result in a disruption of our operations, particularly our online sales operations.

**ITEM 1B. UNRESOLVED STAFF COMMENTS.**

None.

**ITEM 2. PROPERTIES.**

All of our stores are owned or leased from third parties. Our third-party store leases typically provide for rental payments based on a percentage of net sales with a guaranteed minimum annual rent. In general, the Company pays the cost of insurance, maintenance and real estate taxes related to the leases.

The following table summarizes the number of retail stores owned or operated by us and the percentage of total store area represented by each listed category at February 2, 2008:

	<u>Number of stores</u>	<u>% of total store square footage</u>
Owned stores .....	247	77.0 %
Leased stores .....	48	13.1 %
Owned building on leased land .....	19	6.4 %
Partly owned and partly leased .....	<u>12</u>	<u>3.5 %</u>
	<u>326</u>	<u>100.0 %</u>

At February 2, 2008, we had eight regional distribution facilities located throughout the United States of which we own six and lease two from third parties. Our principal executive offices are approximately 300,000 square feet located in Little Rock, Arkansas. Additional information is contained in Notes 1, 3, 13, 14 and 15 of "Notes to Consolidated Financial Statements," in Item 8 hereof, and reference is made to information contained under the headings "Number of stores" and "Gross square footage," under Item 6 hereof.

**ITEM 3. LEGAL PROCEEDINGS.**

From time to time, we are involved in litigation relating to claims arising out of our operations in the normal course of business. Such issues may relate to litigation with customers, employment related lawsuits, class action lawsuits, purported class action lawsuits and actions brought by governmental authorities. As of April 2, 2008, we are not a party to any legal proceedings that, individually or in the aggregate, are reasonably expected to have a material adverse effect on our business, results of operations, financial condition or cash flows. However, the results of these matters cannot be predicted with certainty, and an unfavorable resolution of one or more of these matters could have a material adverse effect on our business, results of operations, financial condition or cash flows.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

No matter was submitted to a vote of security holders during the fourth quarter of the year ended February 2, 2008.

## Executive Officers of the Company

The following table lists the names and ages of all Executive Officers of the Registrant, the nature of any family relationship between them and all positions and offices with the Registrant presently held by each person named. All of the Executive Officers listed below have been in managerial positions with the registrant for more than five years.

<u>Name</u>	<u>Age</u>	<u>Position &amp; Office</u>	<u>Family Relationship</u>
William Dillard, II	63	Director; Chief Executive Officer	None
Alex Dillard	58	Director; President	Brother of William Dillard, II
Mike Dillard	56	Director; Executive Vice President	Brother of William Dillard, II
G. Kent Burnett	63	Vice President	None
Drue Corbusier	61	Director; Executive Vice President	Sister of William Dillard, II
James I. Freeman	58	Director; Senior Vice President; Chief Financial Officer	None
Steven K. Nelson	50	Vice President	None
Robin Sanderford	61	Vice President	None
Paul J. Schroeder	60	Vice President; General Counsel	None
Burt Squires	58	Vice President	None
Julie A. Taylor	56	Vice President	None
David Terry	59	Vice President	None

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, AND RELATED MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

The Company's Class A Common Stock trades on the New York Stock Exchange under the Ticker Symbol "DDS". No public market currently exists for the Class B Common Stock.

The high and low sales prices of the Company's Class A Common Stock, and dividends declared on each class of common stock, for each quarter of fiscal 2007 and 2006 are presented in the table below:

	2007		2006		Dividends per Share	
	High	Low	High	Low	2007	2006
First .....	\$35.82	\$31.70	\$26.79	\$24.23	\$0.04	\$0.04
Second .....	39.90	25.62	32.04	25.42	0.04	0.04
Third .....	26.40	19.68	33.63	29.94	0.04	0.04
Fourth .....	21.73	14.93	36.09	28.74	0.04	0.04

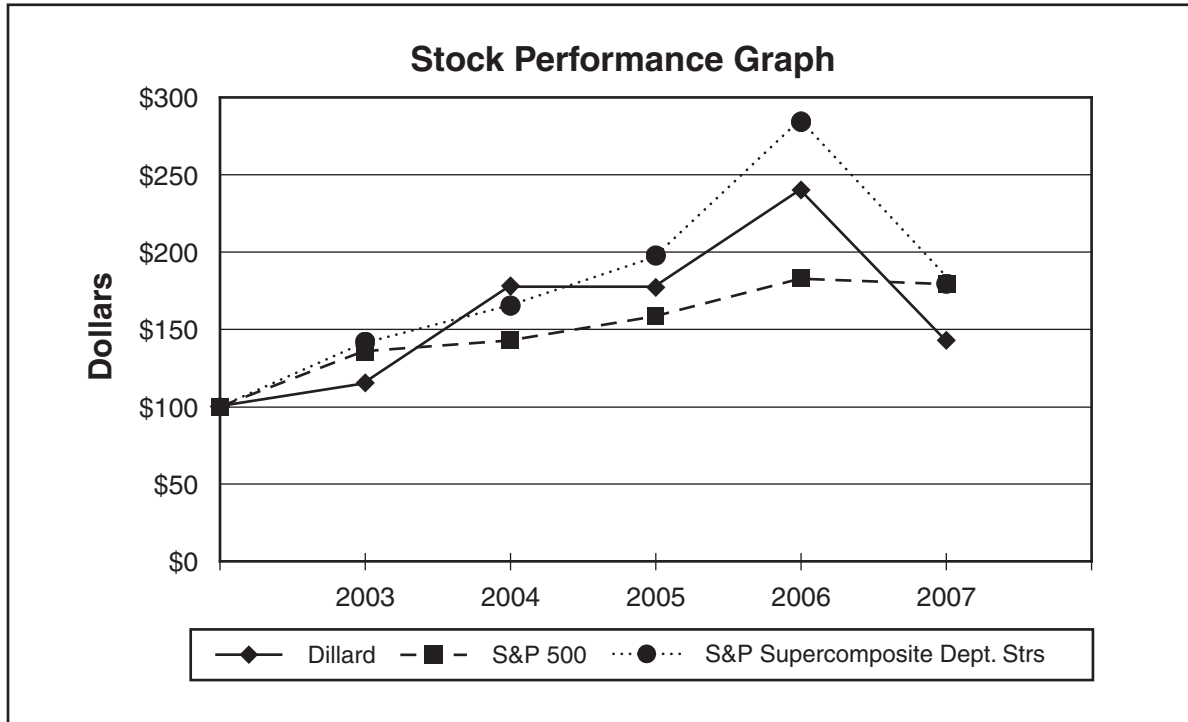
While the Company expects to continue its cash dividend policy during fiscal 2008, all subsequent dividends will be reviewed quarterly and declared by the board of directors.

As of March 1, 2008, there were 3,740 holders of record of the Company's Class A Common Stock and 8 holders of record of the Company's Class B Common Stock.

In November 2007, the Company announced that the Board of Directors authorized the repurchase of up to \$200 million of its Class A Common Stock. The plan has no expiration date, and remaining availability pursuant to the Company's share repurchase program is \$200 million as of February 2, 2008. There were no issuer purchases of equity securities during the fourth quarter of 2007.

## Company Performance

For each of the last five fiscal years, the graph below compares the cumulative total returns on the Company's Class A Common Stock, the Standard & Poor's 500 Index and the Standard & Poor's Supercomposite Department Stores Index. The cumulative total return on the Company's Class A Common Stock assumes \$100 invested in such stock on February 2, 2003 and assumes reinvestment of dividends.



	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Dillard's, Inc. ....	\$100.00	\$114.40	\$176.28	\$176.44	\$239.62	\$141.53
S&P 500 .....	100.00	134.68	141.88	158.42	181.81	178.47
S&P Supercomposite Department Stores .....	100.00	139.71	164.18	196.15	284.53	184.11

## ITEM 6. SELECTED FINANCIAL DATA.

The selected financial data set forth should be read in conjunction with the Company's consolidated audited financial statements and notes thereto and the other information contained elsewhere in this report.

	2007	2006*	2005	2004	2003
	(Dollars in thousands of dollars, except per share data)				
Net sales . . . . .	\$ 7,207,417	\$ 7,636,056	\$ 7,551,697	\$ 7,522,060	\$ 7,594,460
Percent change . . . . .	-6%	1%	0%	-1%	-4%
Cost of sales . . . . .	4,786,655	5,032,351	5,014,021	5,017,765	5,170,173
Percent of sales . . . . .	66.4%	65.9%	66.4%	66.7%	68.1%
Interest and debt expense, net . . . . .	91,556	87,642	105,570	139,056	181,065
Income before income taxes and equity in earnings of joint ventures . . . . .	60,518	253,842	125,791	175,832	7,904
Income taxes . . . . .	13,010	20,580	14,300	66,885	6,650
Equity in earnings of joint ventures . . .	6,253	12,384	9,994	8,719	8,090
Net income . . . . .	53,761	245,646	121,485	117,666	9,344
Per diluted common share					
Net income . . . . .	0.68	3.05	1.49	1.41	0.11
Dividends . . . . .	0.16	0.16	0.16	0.16	0.16
Book value (3) . . . . .	33.45	32.19	29.43	27.85	26.79
Average number of diluted shares outstanding . . . . .	79,103,423	80,475,210	81,660,619	83,739,431	83,899,974
Accounts receivable (1) . . . . .	10,880	10,508	12,523	9,651	1,232,456
Merchandise inventories . . . . .	1,779,279	1,772,150	1,802,695	1,733,033	1,632,377
Property and equipment (3) . . . . .	3,190,444	3,146,626	3,147,623	3,169,476	3,197,469
Total assets (3) . . . . .	5,338,129	5,396,735	5,505,639	5,680,301	6,411,097
Long-term debt (1) . . . . .	760,165	956,611	1,058,946	1,322,824	1,855,065
Capital lease obligations . . . . .	25,739	28,328	31,806	20,182	17,711
Deferred income taxes (3) . . . . .	436,541	448,770	475,007	505,473	617,236
Guaranteed preferred beneficial interests in the Company's subordinated debentures . . . . .	200,000	200,000	200,000	200,000	200,000
Total stockholders' equity (3) . . . . .	2,514,111	2,579,789	2,333,377	2,317,533	2,237,097
Number of employees – average . . . . .	49,938	51,385	52,056	53,035	53,598
Gross square footage (in thousands) . . . .	56,300	56,500	56,400	56,300	56,000
Number of stores					
Opened . . . . .	9	8	9	8	5
Closed (2) . . . . .	11	10	8	7	10
Total – end of year . . . . .	326	328	330	329	328

\* 53 weeks

- (1) During fiscal 2004, the Company sold its private label credit card business to GE Consumer Finance for \$1.1 billion, which included the assumption of \$400 million of long-term securitization liabilities.
- (2) One store in Biloxi, Mississippi, not in operation during fiscal 2007 and fiscal 2006 due to the hurricanes of 2005 and included in the 2006 closed store totals, was re-opened in early fiscal 2008.
- (3) As discussed in Note 2 of the Notes to Consolidated Financial Statements, the Company has restated its Consolidated Balance Sheet and Statement of Stockholders' Equity as of February 3, 2007 and Consolidated Statement of Stockholders' Equity as of January 28, 2006.



The items below are included in the Selected Financial Data.

## 2007

The items below amount to a net \$2.3 million pretax charge (\$10.7 million after tax gain or \$0.13 per diluted share).

- a \$20.5 million pretax charge (\$12.8 million after tax or \$0.16 per diluted share) for asset impairment and store closing charges related to certain stores (see Note 15 of the Notes to Consolidated Financial Statements).
- an \$18.2 million pretax gain (\$11.5 million after tax or \$0.14 per diluted share) related to reimbursement for inventory and property damages incurred during the 2005 hurricane season (see Note 14 of the Notes to Consolidated Financial Statements).
- a \$12.0 million income tax benefit (\$0.15 per diluted share) primarily due to state administrative settlement, federal credits and the change in a capital loss valuation allowance.

## 2006

The items below amount to a net \$9.1 million pretax gain (\$81.8 million after tax gain or \$1.02 per diluted share).

- a \$13.8 million pretax gain (\$8.5 million after tax or \$0.11 per diluted share) on the sale of the Company's interest in a mall joint venture (see Note 1 of the Notes to Consolidated Financial Statements).
- a \$6.5 million pretax gain (\$4.0 million after tax or \$0.05 per diluted share) related to proceeds received from the Visa Check/Mastermoney Antitrust litigation (see Note 13 of the Notes to Consolidated Financial Statements).
- a \$21.7 million pretax charge (\$13.6 million after tax or \$0.17 per diluted share) for a memorandum of understanding reached in a litigation case (see Note 13 of the Notes to Consolidated Financial Statements).
- a \$10.5 million pretax interest credit (\$6.6 million after tax or \$0.08 per diluted share) and a net income tax benefit of \$64.0 million (\$0.80 per diluted share) which includes \$18.3 million for the change in a capital loss valuation allowance. Both the pretax interest credit and the income tax benefit are related to statute expirations and audit settlements with federal and state authorities for multiple tax years.
- a \$5.8 million income tax benefit (\$0.07 per diluted share) for the change in a capital loss valuation allowance due to capital gain income and \$6.5 million tax benefit (\$0.08 per diluted share) due to the release of tax reserves.

## 2005

The items below amount to a net \$32.0 million pretax charge (\$24.7 million after tax gain or \$0.30 per diluted share).

- a \$61.7 million pretax charge (\$39.6 million after tax or \$0.49 per diluted share) for asset impairment and store closing charges related to certain stores (see Note 15 of the Notes to Consolidated Financial Statements).
- a \$29.7 million pretax gain (\$18.9 million after tax or \$0.23 per diluted share) related to hurricane recovery proceeds (see Note 14 of the Notes to Consolidated Financial Statements).
- a \$45.4 million tax benefit (\$0.56 per diluted share) related to the sale of one of the Company's subsidiaries (see Notes 7 and 13 of the Notes to Consolidated Financial Statements).

## 2004

The items below amount to a net \$64.5 million pretax gain (\$42.1 million after tax or \$0.50 per diluted share).

- a pretax gain of \$83.9 million (\$53.7 million after tax or \$0.64 per diluted share) pertaining to the Company's sale of its private label credit card business to GE Consumer Finance.
- a \$19.4 million pretax charge (\$11.6 million after tax or \$0.14 per diluted share) for asset impairment and store closing charges related to certain stores.

## 2003

The items below amount to a net \$18.6 million pretax charge (\$12.8 million after tax or \$0.15 per diluted share).

- a \$43.7 million pretax charge (\$28.9 million after tax or \$0.34 per diluted share) for asset impairment and store closing charges related to certain stores.
- a call premium resulting in additional interest expense of \$15.6 million (\$10.0 million after tax or \$0.12 per diluted share) associated with a \$125.9 million call of debt.
- a pretax gain of \$15.6 million (\$10.0 million after tax or \$0.12 per diluted share) pertaining to the Company's sale of its interest in Sunrise Mall and its associated center in Brownsville, Texas.
- a pretax gain of \$12.3 million (\$7.9 million after tax or \$0.09 per diluted share) recorded due to the resolution of certain liabilities originally recorded in conjunction with the purchase of Mercantile Stores Company, Inc.
- an \$8.7 million pretax gain (\$5.6 million after tax or \$0.07 per diluted share) related to the sale of certain store properties.
- \$4.1 million (\$2.6 million after tax or \$0.03 per diluted share) received from the Internal Revenue Service as a result of the Company's filing of an interest-netting claim related to previously settled tax years.

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

### **EXECUTIVE OVERVIEW**

Dillard's, Inc. operates 326 retail department stores in 29 states. Our stores are located in suburban shopping malls and open-air lifestyle centers and offer a broad selection of fashion apparel and home furnishings. We offer an appealing and attractive assortment of merchandise to our customers at a fair price. We offer national brand merchandise as well as our exclusive brand merchandise. We seek to enhance our income by maximizing the sale of this merchandise to our customers by promoting and advertising our merchandise and by making our stores an attractive and convenient place for our customers to shop.

Fundamentally, our business model is to offer the customer a compelling price/value relationship through the combination of high quality, fashionable products and services at a competitive price. We seek to deliver a high level of profitability and cash flow by:

- maximizing the effectiveness of our pricing and brand awareness;
- minimizing costs through leveraging our centralized overhead expense structure without sacrificing service to our customers;
- sourcing goods from both domestic and foreign enterprises;
- reinvesting operating cash flows into store growth, and distribution initiatives, and improving product quality in our exclusive brands;

- returning profits to shareholders through dividends and share repurchases;
- continuing to offer access to credit services and financial products to our customers through our long-term marketing and servicing alliance with GE Consumer Finance (“GE”); and
- closing under-performing stores where appropriate.

The consumer retail sector is extremely competitive. Many different retail establishments compete for our customers’ business. These include other department stores, specialty retailers, discounters, internet and mail order retailers.

In accordance with the National Retail Federation fiscal reporting calendar, the 2007 and 2005 reporting periods presented and discussed below ended February 2, 2008 and January 28, 2006, respectively, and each contained 52 weeks. The corresponding 2006 reporting period ended February 3, 2007 contained 53 weeks. For comparability purposes, where noted, some of the information discussed below is based upon comparison of the 52 weeks ended February 2, 2008 and January 28, 2006 to the corresponding period ended January 27, 2007.

### Trends and uncertainties

We have identified the following key uncertainties whose fluctuations may have a material effect on our operating results.

- Cash flow—Cash from operating activities is a primary source of liquidity that is adversely affected when the industry faces market driven challenges and new and existing competitors seek areas of growth to expand their businesses.
- Pricing—If our customers do not purchase our merchandise offerings in sufficient quantities, we respond by taking markdowns. If we have to reduce our prices, the cost of goods sold on our income statement will correspondingly rise, thus reducing our income.
- Success of brand—The success of our exclusive brand merchandise is dependent upon customer fashion preferences.
- Store growth—Our growth is dependent on a number of factors which could prevent the opening of new stores, such as identifying suitable markets and locations.
- Sourcing—Store merchandise is dependent upon adequate and stable availability of materials and production facilities from which the Company sources its merchandise.

### 2008 Estimates

A summary of estimates on key financial measures for fiscal 2008 is shown below. There have been no changes in the estimates for 2008 since the Company released its fourth quarter earnings on March 19, 2008.

	<u>2008</u> <u>Estimated</u>	<u>2007</u> <u>Actual</u>
	(In millions of dollars)	
Depreciation . . . . .	\$285	\$299
Rental expense . . . . .	62	60
Interest and debt expense, net . . . . .	92	92
Capital expenditures . . . . .	215	396

### General

**Net sales.** Net sales includes sales of comparable stores and non-comparable stores. Comparable store sales include sales for those stores which were in operation for a full period in both the current month and the corresponding month for the prior year. Non-comparable store sales include sales in the current fiscal year from

stores opened during the previous fiscal year before they are considered comparable stores, sales from new stores opened in the current fiscal year and sales in the previous fiscal year for stores that were closed in the current fiscal year.

**Service charges and other income.** Service charges and other income include income generated through the long-term marketing and servicing alliance between the Company and GE. Other income relates to rental income, shipping and handling fees and net lease income on leased departments.

**Cost of sales.** Cost of sales include the cost of merchandise sold (net of purchase discounts), bankcard fees, freight to the distribution centers, employee and promotional discounts, non-specific vendor allowances and direct payroll for salon personnel.

**Advertising, selling, administrative and general expenses.** Advertising, selling, administrative and general expenses include buying, occupancy, selling, distribution, warehousing, store and corporate expenses (including payroll and employee benefits), insurance, employment taxes, advertising, management information systems, legal and other corporate level expenses. Buying expenses consist of payroll, employee benefits and travel for design, buying and merchandising personnel.

**Depreciation and amortization.** Depreciation and amortization expenses include depreciation and amortization on property and equipment.

**Rentals.** Rentals include expenses for store leases and data processing and equipment rentals.

**Interest and debt expense, net.** Interest and debt expense includes interest, net of interest income, relating to the Company's unsecured notes, mortgage notes, the Guaranteed Beneficial Interests in the Company's subordinated debentures, gains and losses on note repurchases, amortization of financing costs, call premiums and interest on capital lease obligations.

**Gain on disposal of assets.** Gain on disposal of assets includes the net gain or loss on the sale or disposal of property and equipment and joint ventures.

**Asset impairment and store closing charges.** Asset impairment and store closing charges consist of write-downs to fair value of under-performing properties and exit costs associated with the closure of certain stores. Exit costs include future rent, taxes and common area maintenance expenses from the time the stores are closed.

**Equity in earnings of joint ventures.** Equity in earnings of joint ventures includes the Company's portion of the income or loss of the Company's unconsolidated joint ventures.

### **Critical Accounting Policies and Estimates**

The Company's accounting policies are more fully described in Note 1 of Notes to Consolidated Financial Statements. As disclosed in Note 1 of Notes to Consolidated Financial Statements, the preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions about future events that affect the amounts reported in the consolidated financial statements and accompanying notes. Since future events and their effects cannot be determined with absolute certainty, actual results will differ from those estimates. The Company evaluates its estimates and judgments on an ongoing basis and predicates those estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results will differ from these under different assumptions or conditions.

Management of the Company believes the following critical accounting policies, among others, affect its more significant judgments and estimates used in preparation of the Consolidated Financial Statements.

**Merchandise inventory.** Approximately 98% of the inventories are valued at lower of cost or market using the retail last-in, first-out (“LIFO”) inventory method. Under the retail inventory method (“RIM”), the valuation of inventories at cost and the resulting gross margins are calculated by applying a calculated cost to retail ratio to the retail value of inventories. RIM is an averaging method that is widely used in the retail industry due to its practicality. Additionally, it is recognized that the use of RIM will result in valuing inventories at the lower of cost or market if markdowns are currently taken as a reduction of the retail value of inventories. Inherent in the RIM calculation are certain significant management judgments including, among others, merchandise markon, markups, and markdowns, which significantly impact the ending inventory valuation at cost as well as the resulting gross margins. Management believes that the Company’s RIM provides an inventory valuation which results in a carrying value at the lower of cost or market. The remaining 2% of the inventories are valued at lower of cost or market using the specific identified cost method. A 1% change in markdowns would have impacted net income by approximately \$18 million for the year ended February 2, 2008.

**Revenue recognition.** The Company recognizes revenue upon the sale of merchandise to its customers, net of anticipated returns. The provision for sales returns is based on historical evidence of our return rate. We recorded an allowance for sales returns of \$6.8 million and \$7.2 million as of February 2, 2008 and February 3, 2007, respectively. Adjustments to earnings resulting from revisions to estimates on our sales return provision have been insignificant for the years ended February 2, 2008, February 3, 2007 and January 28, 2006.

Prior to the sale of its credit card business to GE, finance charge revenue earned on customer accounts serviced by the Company under its proprietary credit card (“proprietary card”) program was recognized in the period in which it was earned. Beginning November 1, 2004, the Company’s share of income earned under the long-term marketing and servicing alliance is included as a component of service charges and other income. The Company received income of approximately \$119 million, \$125 million and \$105 million from GE in 2007, 2006 and 2005, respectively. Further pursuant to this agreement, the Company has no continuing involvement other than to honor the proprietary cards in its stores. Although not obligated to a specific level of marketing commitment, the Company participates in the marketing of the proprietary cards and accepts payments on the proprietary cards in its stores as a convenience to customers who prefer to pay in person rather than by mailing their payments to GE.

**Merchandise vendor allowances.** The Company receives concessions from its merchandise vendors through a variety of programs and arrangements, including co-operative advertising, payroll reimbursements and margin maintenance programs.

Cooperative advertising allowances are reported as a reduction of advertising expense in the period in which the advertising occurred. If vendor advertising allowances were substantially reduced or eliminated, the Company would likely consider other methods of advertising as well as the volume and frequency of our product advertising, which could increase or decrease our expenditures. Similarly, we are not able to assess the impact of vendor advertising allowances on creating additional revenues, as such allowances do not directly generate revenue for our stores.

Payroll reimbursements are reported as a reduction of payroll expense in the period in which the reimbursement occurred. All other merchandise vendor allowances are recognized as a reduction of cost purchases when received. Accordingly, a reduction or increase in vendor concessions has an inverse impact on cost of sales and/or selling and administrative expenses. The amounts recognized as a reduction in cost of sales have not varied significantly over the past three fiscal years.

**Insurance accruals.** The Company’s consolidated balance sheets include liabilities with respect to self-insured workers’ compensation (with a self-insured retention of \$4 million per claim) and general liability (with a self-insured retention of \$1 million per claim) claims. The Company estimates the required liability of such claims, utilizing an actuarial method, based upon various assumptions, which include, but are not limited to, our historical loss experience, projected loss development factors, actual payroll and other data. The required liability is also

subject to adjustment in the future based upon the changes in claims experience, including changes in the number of incidents (frequency) and changes in the ultimate cost per incident (severity). As of February 2, 2008 and February 3, 2007, insurance accruals of \$55.8 million and \$54.5 million, respectively, were recorded in trade accounts payable and accrued expenses and other liabilities. Adjustments resulting from changes in historical loss trends have reduced expenses during the years ended February 2, 2008 and February 3, 2007, partially due to new Company programs that have helped decrease both the number and cost of claims. Further, we do not anticipate any significant change in loss trends, settlements or other costs that would cause a significant change in our earnings. A 10% change in our self-insurance reserve would have affected net earnings by \$3.5 million for the fiscal year ended February 2, 2008.

**Finite-lived assets.** The Company's judgment regarding the existence of impairment indicators is based on market and operational performance. We assess the impairment of long-lived assets, primarily fixed assets, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include the following:

- Significant changes in the manner of our use of assets or the strategy for our overall business;
- Significant negative industry or economic trends; or
- Store closings.

The Company performs an analysis of the anticipated undiscounted future net cash flows of the related finite-lived assets. If the carrying value of the related asset exceeds the undiscounted cash flows, the carrying value is reduced to its fair value. Various factors including future sales growth and profit margins are included in this analysis. To the extent these future projections or the Company's strategies change, the conclusion regarding impairment may differ from the current estimates.

**Goodwill.** The Company evaluates goodwill annually as of the last day of the fourth quarter and whenever events and changes in circumstances suggest that the carrying amount may not be recoverable from its estimated future cash flows. To the extent these future projections or our strategies change, the conclusion regarding impairment may differ from the current estimates.

Estimates of fair value are primarily determined using projected discounted cash flows and are based on our best estimate of future revenue and operating costs and general market conditions. These estimates are subject to review and approval by senior management. This approach uses significant assumptions, including projected future cash flows, the discount rate reflecting the risk inherent in future cash flows and a terminal growth rate.

**Income taxes.** Temporary differences arising from differing treatment of income and expense items for tax and financial reporting purposes result in deferred tax assets and liabilities that are recorded on the balance sheet. These balances, as well as income tax expense, are determined through management's estimations, interpretation of tax law for multiple jurisdictions and tax planning. If the Company's actual results differ from estimated results due to changes in tax laws, new store locations or tax planning, the Company's effective tax rate and tax balances could be affected. As such these estimates may require adjustment in the future as additional facts become known or as circumstances change.

The Financial Accounting Standards Board issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109* ("FIN 48") effective for fiscal years beginning after December 15, 2006. The Company adopted the new requirement as of February 4, 2007 with the cumulative effects recorded as an adjustment to retained earnings as of the beginning of the period of \$0.8 million. The Company classifies interest expense and penalties relating to income tax in the financial statements as income tax expense. The total amount of unrecognized tax benefits as of the date of adoption was \$27.6 million, of which \$17.8 million would, if recognized, affect the effective tax rate. The total amount of accrued interest and penalty as of the date of adoption was \$13.7 million. The total amount of unrecognized tax benefits as of February 2, 2008 was \$25.4 million, of which \$16.9 million would, if recognized, affect the effective tax rate. The total amount of accrued interest and penalties as of February 2, 2008 was \$8.8 million.

The Company is currently being examined by the Internal Revenue Service for the fiscal tax years 2003 through 2005. The Company is also under examination by various state and local taxing jurisdictions for various fiscal years. The tax years that remain subject to examination for major tax jurisdictions are fiscal tax years 2003 and forward, with the exception of fiscal 1997 through 2002 amended state and local tax returns related to the reporting of federal audit adjustments.

The Company has taken positions in certain taxing jurisdictions for which it is reasonably possible that the total amounts of unrecognized tax benefits may decrease within the next twelve months. The possible decrease could result from the finalization of the Company's federal and various state income tax audits. The Company's federal income tax audit uncertainties primarily relate to research and development credits, while various state income tax audit uncertainties primarily relate to income from intangibles. The estimated range of the reasonably possible uncertain tax benefit decrease in the next twelve months is between \$1 million and \$5 million.

**Discount rate.** The discount rate that the Company utilizes for determining future pension obligations is based on the Citigroup High Grade Corporate Yield Curve on its annual measurement date and is matched to the future expected cash flows of the benefit plans by annual periods. The discount rate had increased to 6.30% as of February 2, 2008 from 5.90% as of February 3, 2007. We believe that these assumptions have been appropriate and that, based on these assumptions, the pension liability of \$114 million is appropriately stated as of February 2, 2008; however, actual results may differ materially from those estimated and could have a material impact on our consolidated financial statements. A further 50 basis point change in the discount rate would generate an experience gain or loss of approximately \$8.0 million. We adopted SFAS No. 158, *Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)* as of February 3, 2007 (see Note 9 in the Notes to Consolidated Financial Statements). The Company expects to make a contribution to the pension plan of approximately \$4.0 million in fiscal 2008. The Company expects pension expense to be approximately \$12.2 million in fiscal 2008 with a liability of \$122.0 million at January 31, 2009.

## RESULTS OF OPERATIONS

The following table sets forth the results of operations and percentage of net sales, for the periods indicated:

	For the years ended					
	February 2, 2008		February 3, 2007		January 28, 2006	
	Amount	% of Net Sales	Amount	% of Net Sales	Amount	% of Net Sales
	(in millions of dollars)					
Net sales . . . . .	\$7,207.4	100.0%	\$7,636.1	100.0%	\$7,551.7	100.0%
Service charges and other income . . . . .	163.4	2.3	174.0	2.3	142.9	1.9
	<u>7,370.8</u>	<u>102.3</u>	<u>7,810.1</u>	<u>102.3</u>	<u>7,694.6</u>	<u>101.9</u>
Cost of sales . . . . .	4,786.7	66.4	5,032.4	65.9	5,014.0	66.4
Advertising, selling, administrative and general expenses . . . . .	2,065.3	28.7	2,096.0	27.5	2,041.5	27.0
Depreciation and amortization . . . . .	298.9	4.2	301.2	3.9	301.9	4.0
Rentals . . . . .	60.0	0.8	55.5	0.7	47.5	0.6
Interest and debt expense, net . . . . .	91.5	1.3	87.6	1.2	105.6	1.4
Gain on disposal of assets . . . . .	(12.6)	(0.2)	(16.4)	(0.2)	(3.4)	—
Asset impairment and store closing charges . . . . .	20.5	0.3	—	—	61.7	0.8
Income before income taxes and equity in earnings of joint ventures . . . . .	60.5	0.8	253.8	3.3	125.8	1.7
Income taxes . . . . .	13.0	0.2	20.6	0.3	14.3	0.2
Equity in earnings of joint ventures . . . . .	6.3	0.1	12.4	0.2	10.0	0.1
Net income . . . . .	<u>\$ 53.8</u>	<u>0.7%</u>	<u>\$ 245.6</u>	<u>3.2%</u>	<u>\$ 121.5</u>	<u>1.6%</u>

## Sales

The percent change by category in the Company's sales for the past two years is as follows:

	Percent Change			
	<u>Fiscal 2007-2006</u>	<u>Fiscal 2007-2006*</u>	<u>Fiscal 2006-2005</u>	<u>Fiscal 2006-2005**</u>
Cosmetics . . . . .	(5.0)%	(3.7)%	1.3%	0.0%
Ladies' Apparel and Accessories . . . . .	(3.8)	(2.2)	1.2	(0.5)
Juniors' and Children's Apparel . . . . .	(10.6)	(9.2)	(5.9)	(7.3)
Men's Apparel and Accessories . . . . .	(7.8)	(5.6)	3.3	1.0
Shoes . . . . .	(1.7)	(0.2)	4.2	2.6
Home and Other . . . . .	(10.3)	(8.9)	(0.3)	(1.8)

\* Percent change based on 52 weeks ended February 2, 2008 and 52 weeks ended January 27, 2007.

\*\* Percent change based on 52 weeks ended January 27, 2007 and 52 weeks ended January 28, 2006.

The percent change by region in the Company's sales for the past two years is as follows:

	Percent Change			
	<u>Fiscal 2007-2006</u>	<u>Fiscal 2007-2006*</u>	<u>Fiscal 2006-2005</u>	<u>Fiscal 2006-2005**</u>
Eastern . . . . .	(6.8)%	(5.3)%	0.4%	(1.2)%
Central . . . . .	(4.9)	(3.2)	0.8	(0.9)
Western . . . . .	(5.3)	(3.7)	3.9	2.2

\* Percent change based on 52 weeks ended February 2, 2008 and 52 weeks ended January 27, 2007.

\*\* Percent change based on 52 weeks ended January 27, 2007 and 52 weeks ended January 28, 2006.

Sales decreased 6% during the 52 weeks ended February 2, 2008 compared to the 53 weeks ended February 3, 2007 in both total and comparable stores. Sales declined 4% during the 52 weeks ended February 2, 2008 compared to the 52 weeks ended January 27, 2007, and comparable store sales decreased 5% for the same 52-week periods. During fiscal 2007, all categories experienced sales declines with the most significant declines noted in the juniors' and children's apparel and home and other categories while sales in the shoes category were nearly flat. All regions also experienced sales declines during fiscal 2007 while sales in the Central and Western regions outperformed the sales in the Eastern region.

Sales increased 1% for the 53 weeks ended February 3, 2007 compared to the 52 weeks ended January 28, 2006, and comparable store sales were unchanged on a percentage basis for the same periods. Sales declined 1% for the 52 weeks ended January 27, 2007 compared to the 52 weeks ended January 28, 2006 in both total and comparable stores. During the 52 weeks ended January 27, 2007, sales were strongest in shoes with sales increases also noted in the men's apparel and accessories category. In the same 52-week period, sales were flat in cosmetics while sales declined in the remaining merchandising categories with a significant decrease noted in juniors' and children's apparel. During the 52 weeks ended January 27, 2007, sales were strongest and increased in the Western region while sales declined in the Central and Eastern regions.

During the year ended January 28, 2006, Hurricane Katrina, Hurricane Rita and Hurricane Wilma interrupted operations in approximately 60 of the Company's stores for varying amounts of time. We are not able to determine with any degree of certainty the impact that these hurricanes had on our results of operations. Property and merchandise losses in the affected stores were covered by insurance. Our insurance coverage did not include business interruption but did include a provision for reimbursement of the loss of inventory in excess of the carrying cost value. Our insurance coverage also covered losses sustained on damaged stores at replacement value. One store in Biloxi, Mississippi, not in operation during fiscal 2006 and 2007, re-opened in March 2008.



Sales penetration of exclusive brand merchandise for the fiscal years 2007, 2006 and 2005 was 24.2%, 23.8% and 24.0% of total net sales, respectively.

### Service Charges and Other Income

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>Dollar Change</u>		<u>Percent Change</u>	
				<u>2007-2006</u>	<u>2006-2005</u>	<u>2007-2006</u>	<u>2006-2005</u>
				(in millions of dollars)			
Leased department income . . . . .	\$ 13.0	\$ 10.4	\$ 8.5	\$ 2.6	\$ 1.9	25.0%	22.4%
Income from GE marketing and servicing alliance . . . . .	118.8	124.6	104.8	(5.8)	19.8	(4.7)	18.9
Visa Check/Mastermoney Antitrust settlement proceeds . . . . .	—	6.5	—	(6.5)	6.5	(100.0)	—
Other . . . . .	31.6	32.5	29.6	(0.9)	2.9	(2.8)	9.8
Total . . . . .	<u>\$163.4</u>	<u>\$174.0</u>	<u>\$142.9</u>	<u>\$(10.6)</u>	<u>\$31.1</u>	<u>(6.1)%</u>	<u>21.8%</u>

#### 2007 Compared to 2006

Service charges and other income is composed primarily of income from the Company’s marketing and servicing alliance with GE Consumer Finance (“GE”). This marketing and servicing alliance began on November 1, 2004 in conjunction with the sale of our credit card business to GE and included income of \$118.8 million in fiscal 2007 compared to income of \$124.6 million for fiscal 2006. This decrease of \$5.8 million was due primarily to an increase in account write-offs.

Other items included in other income in fiscal 2007 included income of \$13.0 million from leased departments compared to \$10.4 million of leased department income in fiscal 2006 due to the increased sales performance of one of our leased departments.

#### 2006 Compared to 2005

Service charges and other income included income from the marketing and servicing alliance with GE of \$124.6 million in fiscal 2006 compared to income of \$104.8 million for fiscal 2005. This increase of \$19.8 million was due primarily to an increase in finance charges due to higher receivable balances caused by a slowing in the rate of customers’ payments as a result of a change in payment terms by GE.

Other items included in other income in fiscal 2006 included \$6.5 million of proceeds received from the Visa Check/Mastermoney Antitrust litigation settlement and income of \$10.4 million from leased departments compared to \$8.5 million of leased department income in fiscal 2005.

### Cost of Sales

#### 2007 Compared to 2006

Cost of sales as a percentage of sales increased to 66.4% of sales during fiscal 2007 from 65.9% during fiscal 2006. Included in cost of sales during fiscal 2007 was a \$4.1 million gain related to reimbursement for merchandise losses incurred during the 2005 hurricane season. Exclusive of this gain, cost of sales as a percentage of sales was 66.5% of sales during fiscal 2007. The gross margin decline of 60 basis points of sales was primarily driven by higher markdowns as the Company responded to lackluster sales performance in an effort to maintain appropriate inventory control. The higher markdown activity was partially offset by higher markups. Total inventory at February 2, 2008 compared to February 3, 2007 remained flat while inventory in comparable stores decreased 1% between the periods. All merchandise categories experienced declines in gross margin with the exception of men’s apparel and accessories which was up only slightly. The weakest performance was noted in the home and other category, which significantly exceeded the Company’s average decline for the year.

### ***2006 Compared to 2005***

Cost of sales as a percentage of sales decreased to 65.9% during fiscal 2006 compared with 66.4% for fiscal 2005, resulting in gross margin improvement of 50 basis points of sales. Included in gross margin for fiscal 2005 is a \$29.7 million hurricane recovery gain related to insurance settlements received covering losses incurred in the 2005 hurricane season. Excluding the effect of the hurricane gain which had an impact of 40 basis points of sales, gross margin improved 90 basis points of sales as a result of lower levels of markdowns partially offset by lower markups during the year ended February 3, 2007 compared to the year ended January 28, 2006. Gross margins were higher in cosmetics, ladies' apparel and accessories, juniors' and children's apparel and shoes compared to the prior year with lower gross margins noted in men's apparel and accessories and home and other categories.

### **Expenses**

#### ***2007 Compared to 2006***

Advertising, selling, administrative and general ("SG&A") increased to 28.7% of sales during fiscal 2007 from 27.5% in fiscal 2006 while total dollars decreased by \$30.7 million. Aside from the lack of sales leverage, the dollars decreased between the two periods primarily as a result of a \$21.7 million charge in the prior year for a preliminary settlement agreement reached in a lawsuit filed on behalf of a putative class of former Mercantile Stores Pension Plan participants. This decrease was further enhanced by a decrease in payroll expense of \$17.6 million (primarily due to the addition of the 53<sup>rd</sup> week of fiscal 2006) and advertising savings of \$7.8 million (as we continue to reposition our advertising efforts toward the most appropriate media sources to reach our targeted customers) partially offset by an increase in services purchased of \$11.0 million (as a result of increases in legal and transportation costs).

Depreciation and amortization expense decreased \$2.3 million during fiscal 2007 to \$298.9 million from \$301.2 million in fiscal 2006. This decrease was primarily due to the addition of the 53<sup>rd</sup> week of fiscal 2006.

Rental expense increased to \$60.0 million in fiscal 2007 or 0.8% of sales compared to \$55.5 million or 0.7% of sales in fiscal 2006. This increase of \$4.5 million was a result of higher equipment rent compared to the prior year partially offset by a decline in the number of leased stores.

Interest and debt expense, net, increased to \$91.5 million in fiscal 2007 compared to \$87.6 million in fiscal 2006. This increase of \$3.9 million was primarily due to an interest credit in the prior year of \$10.5 million related to statute expirations and audit settlements with federal and state tax authorities for multiple tax years. Exclusive of this interest credit, net interest and debt expense decreased \$6.6 million in fiscal 2007 compared to fiscal 2006 mainly due to lower weighted average total debt in the current year of \$1.1 billion compared to \$1.2 billion in the prior year as well as an increase in capitalized interest of \$2.0 million between the same periods. These decreases were partially offset by a decrease in investment income of \$5 million in fiscal 2007 compared to fiscal 2006.

Gain on disposal of assets decreased \$3.8 million for the year ended February 2, 2008 to \$12.6 million compared to \$16.4 million for the prior year. The decrease was primarily due a pretax gain of \$13.5 million recognized in the prior year related to the sale of the Company's interest in the Yuma Palms joint venture for \$20.0 million. The decrease between the periods was further enhanced by the Company's sale of properties in Longmont, Colorado and Richardson, Texas in fiscal 2007 for \$5.8 million, resulting in a net loss of \$2.5 million on the sales. These decreases were partially offset by a \$14.1 million pretax gain recognized in the current year relating to hurricane recovery for two stores damaged by the hurricanes of 2005 as the Company completed the cleanup of the damaged locations during fiscal 2007.

Asset impairment and store closing charges were \$20.5 million or 0.3% of sales during fiscal 2007. No asset impairment and store closing charges were recorded during fiscal 2006. The 2007 charges consist of a write-off

of goodwill on one store of \$2.6 million that was closed during the year, an accrual for future rent, property tax and utility payments on two stores of \$1.0 million that were also closed during the year and a write-down of property and equipment on 14 stores of \$16.9 million that were closed, scheduled to close or impaired based on the inability of the stores' estimated future cash flows to sustain their carrying value. A breakdown of the asset impairment and store closing charges for fiscal 2007 follows:

	<u>Number of Locations</u>	<u>Impairment Amount</u>
	(in thousands of dollars)	
Store closed in prior year . . . . .	1	\$ 687
Stores closed in fiscal 2007 . . . . .	4	3,647
Stores to close in fiscal 2008 . . . . .	5	5,083
Stores impaired based on cash flows . . . . .	6	9,113
Non-operating facility . . . . .	<u>1</u>	<u>1,970</u>
Total . . . . .	<u>17</u>	<u>\$20,500</u>

### ***2006 Compared to 2005***

Advertising, selling, administrative and general (“SG&A”) expenses increased to 27.5% of sales for fiscal 2006 compared to 27.0% for fiscal 2005. During fiscal 2006, SG&A expenses increased \$54.5 million primarily because of increases in payroll expense of \$45.4 million, utilities expense of \$12.0 million, and a \$21.7 million charge for the Mercantile Stores Pension Plan settlement agreement. These increases were partially offset by savings in advertising expenses of \$23.3 million. The increase in payroll expense was due to an increase in incentive compensation to store managers, merchants and management due to improved company performance during fiscal 2006 as well as the addition of the 53<sup>rd</sup> week in fiscal 2006. The increase in utility expense was a result of higher utility rates compared to the prior year in addition to the 53<sup>rd</sup> week in fiscal 2006. The savings in advertising expense was mainly due to the repositioning of our advertising efforts toward the most appropriate media sources to reach our targeted customers.

Depreciation and amortization expense decreased slightly to 3.9% of sales for fiscal 2006 compared to 4.0% of sales in fiscal 2005.

Rental expense as a percentage of net sales was 0.7% for the year ended February 3, 2007 compared to 0.6% for the same period in fiscal 2005. The increase of \$8.0 million in rental expense during fiscal 2006 was a result of higher equipment rent compared to the prior year partially offset by a decline in the number of leased stores.

Interest and debt expense, net, decreased to 1.2% of sales for fiscal 2006 compared to 1.4% of sales for fiscal 2005 as a result of lower debt levels and due to an interest credit of \$10.5 million related to statute expirations and audit settlements with federal and state tax authorities for multiple tax years. Interest and debt expense declined \$18.0 million during fiscal 2006. Average debt outstanding declined approximately \$179 million in fiscal 2006. The Company had maturities and repurchases of \$200.2 million on various notes and mortgages during 2006.

During 2006, the Company sold its interest in a joint venture, Yuma Palms, for \$20.0 million, and recognized a gain of \$13.5 million which is included in gain on disposal of assets.

No asset impairment and store closing charges were recorded during fiscal 2006 compared to \$61.7 million or 0.8% of sales recorded during fiscal 2005. The fiscal 2005 charge included a write-down to fair value for certain under-performing properties. Included in asset impairment and store closing charges is a pretax loss on the disposition of all the outstanding capital stock of an indirect wholly-owned subsidiary in the amount of \$40.1 million. The Company realized an income tax benefit of \$45.4 million for the year ended January 28, 2006 related to the sale of the subsidiary's stock. The charge also consists of a write-down of goodwill on one store of

\$1.0 million, an accrual for future rent, property tax and utility payments on four stores of \$3.7 million and a write-down of property and equipment on nine stores in the amount of \$16.9 million. A breakdown of the asset impairment and store closing charges for fiscal 2005 is as follows:

	<u>Number of Locations</u>	<u>Impairment Amount</u>
	(in thousands of dollars)	
Stores closed during fiscal 2005 .....	5	\$ 8,729
Stores impaired based on cash flows .....	9	12,899
Wholly-owned subsidiary .....	<u>7</u>	<u>40,106</u>
Total .....	<u>21</u>	<u>\$61,734</u>

## Income Taxes

The federal and state income tax rates for fiscal 2007, 2006 and 2005, inclusive of equity in earnings of joint ventures, were 19.5%, 7.7% and 10.5%, respectively.

During the year ended February 2, 2008, the Company recorded an income tax benefit relating to a net decrease in FIN 48 liabilities of approximately \$5.9 million, a recognition of tax benefits of approximately \$1.7 million for the change in a capital loss valuation allowance due to capital gain income, approximately \$1.3 million for a reduction in state tax liabilities due to a restructuring that occurred during this period and approximately \$3.3 million due to federal tax credits. During fiscal 2007, the IRS continued an examination of the Company's federal income tax returns for fiscal years 2003 through 2005. The Company is also under examination by various state and local taxing jurisdictions for various fiscal years.

During the year ended February 3, 2007, income taxes included a \$57.2 million reduction of reserves for various federal and state tax contingencies, a \$3.5 million increase in deferred liabilities due to an increase in the state effective tax rate, and a \$24.4 million tax benefit related to the decrease in a capital loss valuation allowance due to capital gain income.

## LIQUIDITY AND CAPITAL RESOURCES

### Financial Position Summary

	<u>2007</u>	<u>2006</u>	<u>Dollar Change</u>	<u>Percent Change</u>
	(in thousands of dollars)			
Cash and cash equivalents .....	\$ 88,912	\$ 193,994	\$(105,082)	(54.2)%
Other short-term borrowings .....	195,000	—	195,000	—
Current portion of long-term debt .....	196,446	100,635	95,811	95.2
Long-term debt .....	760,165	956,611	(196,446)	(20.5)
Guaranteed Beneficial Interests .....	200,000	200,000	—	—
Stockholders' equity .....	2,514,111	2,579,789	(65,678)	(2.5)
Current ratio .....	1.64	2.10		
Debt to capitalization .....	35.0%	32.8%		

The Company's current non-operating priorities for its use of cash are:

- Strategic investments to enhance the value of existing properties;
- Construction of new stores;

- Investment in high-return capital projects, particularly in investments in technology to improve merchandising and distribution, reduce costs, to improve efficiencies or to help the Company better serve its customers;
- Debt reduction;
- Stock repurchase plan; and
- Dividend payments to shareholders.

Cash flows for the three fiscal years ended were as follows:

	2007	2006	2005	Percent Change	
				2007-2006	2006-2005
(in thousands of dollars)					
Operating Activities	\$ 254,449	\$ 360,582	\$ 369,142	(29.4)%	(2.3)%
Investing Activities	(331,987)	(266,345)	(297,608)	(24.7)	10.5
Financing Activities	(27,544)	(200,083)	(269,942)	86.2	25.9
Total Cash Used	<u>\$(105,082)</u>	<u>\$(105,846)</u>	<u>\$(198,408)</u>		

### Operating Activities

The primary source of the Company's liquidity is cash flows from operations. Due to the seasonality of the Company's business, it has historically realized a significant portion of the cash flows from operating activities during the second half of the fiscal year. Retail sales are the key operating cash component providing 97.8% of total revenues over the past two years.

GE Consumer Finance ("GE") owns and manages the Company's private label credit card business under a long-term marketing and servicing alliance ("alliance") that expires in fiscal 2014. The alliance provides for certain payments to be made by GE to the Company, including a revenue sharing and marketing reimbursement. The cash flows that the Company receives under this alliance have been greater than the net cash flows provided by the Company's credit business prior to its sale to GE in 2004 due to quicker cash receipts. The Company received income of approximately \$119 million and \$125 million from GE in fiscal 2007 and 2006. While the Company does not expect future cash flows under this alliance to vary significantly from historical levels, future amounts are difficult to predict. The amount the Company receives is dependent on the level of sales on GE accounts, the level of balances carried on the GE accounts by GE customers, payment rates on GE accounts, finance charge rates and other fees on GE accounts, the level of credit losses for the GE accounts as well as GE's funding costs.

Operating cash inflows also include revenue and reimbursements from the long-term marketing and servicing alliance with GE and cash distributions from joint ventures. Operating cash outflows include payments to vendors for inventory, services and supplies, payments to employees, and payments of interest and taxes.

Net cash flows from operations were \$254.4 million for fiscal 2007 versus \$360.6 million for fiscal 2006. Net income, as adjusted for non-cash items, was \$140 million lower in fiscal 2007 than in fiscal 2006 primarily as a result of lower net income. Operating cash flows from changes in operating assets and liabilities were positively impacted by \$28 million in fiscal 2007 versus fiscal 2006, mainly due to the changes in current assets that were impacted by the hurricane insurance receivable from the prior year for inventory and property damages incurred during the 2005 hurricane season and the receipt of related proceeds in the current year.

We received insurance proceeds of \$5.9 million and \$83.4 million during fiscal 2007 and 2005, respectively, related to the hurricane damaged inventory. Combined with the hurricane insurance proceeds recorded in investing activities, the Company recorded related gains in fiscal 2007 of \$14.1 million and \$4.1 million in gain on disposal of assets and cost of sales, respectively. The Company recorded a related gain of \$29.7 million in 2005 in cost of sales.

## Investing Activities

Cash inflows from investing activities generally include proceeds from sales of property and equipment and joint ventures. Investment cash outflows generally include payments for capital expenditures such as property and equipment.

Capital expenditures were \$396.3 million for 2007. These expenditures consisted primarily of the construction of new stores, remodeling of existing stores and investments in technology equipment and software. Store openings and closures during fiscal 2007 were:

<u>New Locations—Fiscal 2007</u>	<u>City</u>	<u>Square Feet</u>
Eastland Mall .....	Evansville, Indiana	180,000
Stones River Mall* .....	Murfreesboro, Tennessee	145,000
Alamance Crossing .....	Burlington, North Carolina	126,000
Stonebriar Centre .....	Frisco, Texas	200,000
Ashley Park .....	Newnan, Georgia	162,000
Hill Country Galleria .....	West Austin, Texas	145,000
Fallen Timbers* .....	Toledo, Ohio	155,000
Santan Village .....	Gilbert, Arizona	155,000
Promenade at Casa Grande .....	Casa Grande, Arizona	98,000
Total new square footage .....		<u>1,366,000</u>
<u>Closed Locations—Fiscal 2007</u>	<u>City</u>	<u>Square Feet</u>
Stones River Mall* .....	Murfreesboro, Tennessee	110,000
Shively Center .....	Louisville, Kentucky	156,000
Midway Mall .....	Elyria, Ohio	158,000
Crestwood Plaza .....	St. Louis, Missouri	170,000
Bellevue Mall .....	Nashville, Tennessee	170,000
Southwyck Shopping Center* .....	Toledo, Ohio	180,000
Eastland Mall (clearance center) .....	Tulsa, Oklahoma	160,000
Southwest Center .....	Dallas, Texas	160,000
National Hills Shopping Center .....	Augusta, Georgia	88,000
Tallahassee Mall .....	Tallahassee, Florida	170,000
Ashtabula Mall .....	Ashtabula, Ohio	70,000
Total closed square footage .....		<u>1,592,000</u>

\* replacement store

One location in Biloxi, Mississippi that was closed during fiscal 2006 as a result of Hurricane Katrina was still under reconstruction during fiscal 2007. This store re-opened in March 2008 as planned.

Capital expenditures for 2008 are expected to be approximately \$215 million. These expenditures include the openings of nine locations, in addition to the store that re-opened in Biloxi, Mississippi, totaling approximately 1.3 million square feet. Historically, we have financed such capital expenditures with cash flow from operations. We expect that we will continue to finance capital expenditures in this manner during fiscal 2008.

We received insurance proceeds of \$16.1 million, \$27.8 million and \$26.7 million during fiscal 2007, 2006 and 2005, respectively, for the construction of property and fixtures for stores damaged during the 2005 hurricane season.

We have approximately 95 stores along the Gulf and Atlantic coasts that will not be covered by third party insurance but will rather be self-insured for property and merchandise losses related to “named storms” in fiscal 2008. Therefore, repair and replacement costs will be borne by us for damage to any of these stores from “named storms” in fiscal 2008. We have created early response teams to assess and coordinate cleanup efforts should some stores be impacted by storms. We have also redesigned certain store features to lessen the impact of storms and have equipment available to assist in the efforts to ready the stores for normal operations.

During fiscal 2007, 2006 and 2005, we received proceeds from the sale of property and equipment of \$48.2 million, \$6.5 million and \$103.6 million, respectively, and recorded a related loss in operating activities of \$1.5 million for fiscal 2007 and related gains of \$2.6 million and \$3.4 million for fiscal 2006 and 2005, respectively. During 2005, we received cash proceeds of \$14.0 million and a \$3.0 million promissory note from the sale of a subsidiary and also received \$14.1 million as a return of capital from a joint venture.

## **Financing Activities**

Our primary source of cash inflows from financing activities is our \$1.2 billion revolving credit facility. Financing cash outflows generally include the repayment of borrowings under the revolving credit facility, the repayment of mortgage notes or long-term debt, the payment of dividends and the purchase of treasury stock.

**Revolving Credit Agreement.** At February 2, 2008, we maintained a \$1.2 billion revolving credit facility (“credit agreement”) with JPMorgan Chase Bank (“JPMorgan”) as agent for various banks, secured by the inventory of Dillard’s, Inc. operating subsidiaries. The credit agreement expires December 12, 2012. Borrowings under the credit agreement accrue interest at either JPMorgan’s Base Rate minus 0.5% or LIBOR plus 1.0% (4.14% at February 2, 2008) subject to certain availability thresholds as defined in the credit agreement. Availability for borrowings and letter of credit obligations under the credit agreement is limited to 85% of the inventory of certain Company subsidiaries (approximately \$1.0 billion at February 2, 2008). At February 2, 2008, borrowings of \$195 million were outstanding and letters of credit totaling \$72.5 million were issued under this facility leaving unutilized availability under the facility of \$768 million. There are no financial covenant requirements under the credit agreement provided availability exceeds \$100 million. We pay an annual commitment fee to the banks of 0.25% of the committed amount less outstanding borrowings and letters of credit. Weighted average borrowings during fiscal 2007 were \$108.3 million compared to \$10.6 million during fiscal 2006.

**Long-term Debt.** At February 2, 2008, the Company had \$957 million of unsecured notes and a mortgage note outstanding. The unsecured notes bear interest at rates ranging from 6.30% to 9.50% with due dates from 2008 through 2028, and the mortgage note bears interest at 9.25% with a due date of 2013. No notes were repurchased during 2007 compared to repurchases of \$1.7 million of outstanding, unsecured notes during fiscal 2006. We reduced our net level of outstanding debt and capital leases during 2007 by \$104.3 million compared to a reduction of \$205.9 million in 2006. The decline in total debt for 2007 was due to regular maturities of an outstanding note and mortgage. The 2006 reduction was due to both maturities and repurchases of various outstanding notes and mortgages. Maturities of long-term debt over the next five years are \$196 million, \$25 million, \$1 million, \$57 million and \$56 million.

**Stock Repurchase.** During 2006, the Company repurchased 133,500 shares for \$3.3 million under the 2005 stock repurchase plan (“2005 plan”) which was approved by the board of directors in May 2005 and authorized the repurchase of up to \$200 million of its Class A Common Stock. During 2007, the Company repurchased 5.2 million shares under the 2005 plan for \$111.6 million which completed the authorization under this plan.

In November 2007, the Company’s Board of Directors authorized a new share repurchase plan under which the Company may repurchase up to \$200 million of its Class A common stock. The new open-ended authorization permits the Company to repurchase its Class A common stock in the open market or through privately negotiated transactions.

**Guaranteed Beneficial Interests in the Company's Subordinated Debentures.** The Company has \$200 million liquidation amount of 7.5% Capital Securities, due August 1, 2038 representing the beneficial ownership interest in the assets of Dillard's Capital Trust I, a consolidated entity of the Company.

### Fiscal 2008

During fiscal 2008, the Company expects to finance its capital expenditures and its working capital requirements including required debt repayments and stock repurchases, if any, from cash on hand, cash flows generated from operations and utilization of the credit facility. The peak borrowings incurred under the credit facilities were \$430 million during 2007 and are expected to be approximately \$550 million during fiscal 2008. The Company attributes the increase to the maturity of a \$100 million note outstanding occurring during the peak borrowing season. Depending on conditions in the capital markets and other factors, the Company will from time to time consider possible financing transactions, the proceeds of which could be used to refinance current indebtedness or other corporate purposes.

### OFF-BALANCE-SHEET ARRANGEMENTS

The Company has not created, and is not party to, any special-purpose or off-balance-sheet entities for the purpose of raising capital, incurring debt or operating the Company's business. The Company does not have any arrangements or relationships with entities that are not consolidated into the financial statements that are reasonably likely to materially affect the Company's liquidity or the availability of capital resources.

### CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

To facilitate an understanding of the Company's contractual obligations and commercial commitments, the following data is provided:

#### PAYMENTS DUE BY PERIOD

	<u>Total</u>	<u>Less than 1 year</u>	<u>1-3 years</u>	<u>3-5 years</u>	<u>More than 5 years</u>
	(in thousands of dollars)				
Contractual Obligations					
Long-term debt . . . . .	\$ 956,611	\$ 196,446	\$ 25,490	\$113,043	\$ 621,632
Interest on long-term debt . . . . .	752,247	62,209	110,554	100,627	478,857
Guaranteed beneficial interests in the Company's subordinated debentures . . . . .	200,000	—	—	—	200,000
Interest on guaranteed beneficial interests in the Company's subordinated debentures . . . . .	457,356	14,918	29,918	30,164	382,356
Other short-term borrowings . . . . .	195,000	195,000	—	—	—
Capital lease obligations, including interest . . . .	41,243	4,684	7,197	17,296	12,066
Defined benefit plan payments . . . . .	113,715	3,961	10,254	10,450	89,050
Purchase obligations (1) . . . . .	1,524,916	1,524,916	—	—	—
Operating leases (2) . . . . .	255,691	56,065	87,339	79,144	33,143
Total contractual cash obligations (3) (4) . . . . .	<u>\$4,496,779</u>	<u>\$2,058,199</u>	<u>\$270,752</u>	<u>\$350,724</u>	<u>\$1,817,104</u>

(1) The Company's purchase obligations principally consist of purchase orders for merchandise and store construction commitments. Amounts committed under open purchase order for merchandise inventory represent \$1.4 billion of the purchase obligations, of which a significant portion are cancelable without penalty prior to a date that precedes the vendor's scheduled shipment date.

(2) The operating leases included in the above table do not include contingent rent based upon sales volume, which represented approximately 10% of minimum lease obligations in fiscal 2007.



- (3) The total liability for Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) uncertain tax positions is approximately \$34.2 million, including tax, penalty and interest (refer to Note 7 to the consolidated financial statements). We are not able to reasonably estimate the timing of future cash flows and have excluded these liabilities from the table above; however, at this time, we do not expect a significant payment relating to these obligations within the next year.
- (4) Other long-term liabilities consist of workers' compensation and general liability insurance reserves. We are unable to reasonably estimate the timing of future cash flows for the remaining balance and have excluded this in the table above.

#### AMOUNT OF COMMITMENT EXPIRATION PER PERIOD

	<u>Total Amounts Committed</u>	<u>Within 1 year</u>	<u>2-3 years</u>	<u>4-5 years</u>	<u>After 5 years</u>
	(in thousands of dollars)				
Other Commercial Commitments					
\$1.2 billion line of credit, none outstanding (1) . . . . .	\$ —	\$ —	\$ —	\$—	\$—
Standby letters of credit . . . . .	66,025	63,025	3,000	—	—
Import letters of credit . . . . .	6,512	6,512	—	—	—
Total commercial commitments . . . . .	<u>\$72,537</u>	<u>\$69,537</u>	<u>\$3,000</u>	<u>\$—</u>	<u>\$—</u>

(1) Availability under the credit facility is limited to 85% of the inventory of certain Company subsidiaries (approximately \$1.0 billion at February 2, 2008) which has not been reduced by outstanding short-term borrowings of \$195.0 million or outstanding letters of credit of \$72.5 million.

#### NEW ACCOUNTING PRONOUNCEMENTS

In December 2007, the Financial Accounting Standards Board ("FASB") issued the Statement of Financial Accounting Standards ("SFAS") No. 141(R), *Business Combinations* ("SFAS 141(R)"). SFAS 141(R)'s objective is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after December 31, 2008. We expect that the adoption of SFAS 141(R) will not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued the SFAS No. 160, *Noncontrolling Interest in Consolidated Financial Statements* ("SFAS 160"). SFAS 160's objective is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 will be effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. We expect that the adoption of SFAS 160 will not have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115* ("SFAS 159"). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective at the beginning of an entity's first fiscal year that begins after November 15, 2007. We expect that the adoption of SFAS 159 will not have a material impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement applies under other

accounting pronouncements that require or permit fair value measurements, the FASB having concluded in those other accounting pronouncements that fair value is the relevant measurement attribute. This statement is effective for financial assets and liabilities in financial statements issued for fiscal years beginning after November 15, 2007. It is effective for non-financial assets and liabilities in financial statements issued for fiscal years beginning after November 15, 2008. We expect that the adoption of SFAS 157 will not have a material impact on our consolidated financial statements.

In December 2007, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin (“SAB”) No. 110 to extend the use of “simplified method” for estimating the expected terms of “plain vanilla” employee stock options for the awards valuation. The method was initially allowed under SAB 107 in contemplation of the adoption of SFAS 123(R) to expense the compensation cost based on the awards grant date fair value. SAB 110 does not provide an expiration date for the use of the method. However, as more external information about exercise behavior will be available over time, it is expected that this method will not be used when more relevant information is available.

In February 2008, the FASB issued FSP SFAS 157-2, *Effective Date for FASB Statement No. 157*. This FSP permits the delayed application of SFAS 157 for all nonrecurring fair value measurements of nonfinancial assets and nonfinancial liabilities until fiscal years beginning after November 15, 2008. The Company has chosen to adopt SFAS 157 in accordance with the guidance of FSP SFAS 157-2 as stated above.

## **FORWARD-LOOKING INFORMATION**

This report contains certain forward-looking statements. The following are or may constitute forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995: (a) Words such as “may,” “will,” “could,” “believe,” “expect,” “future,” “potential,” “anticipate,” “intend,” “plan,” “estimate,” “continue,” or the negative or other variations thereof, and (b) statements regarding matters that are not historical facts. The Company cautions that forward-looking statements contained in this report are based on estimates, projections, beliefs and assumptions of management and information available to management at the time of such statements and are not guarantees of future performance. The Company disclaims any obligation to update or revise any forward-looking statements based on the occurrence of future events, the receipt of new information, or otherwise. Forward-looking statements of the Company involve risks and uncertainties and are subject to change based on various important factors. Actual future performance, outcomes and results may differ materially from those expressed in forward-looking statements made by the Company and its management as a result of a number of risks, uncertainties and assumptions, including the matters described under the caption “Risk Factors” above. Representative examples of those factors include (without limitation) general retail industry conditions and macro-economic conditions; economic and weather conditions for regions in which the Company’s stores are located and the effect of these factors on the buying patterns of the Company’s customers, including the effect of changes in changes in prices and availability of oil and natural gas; the impact of competitive pressures in the department store industry and other retail channels including specialty, off-price, discount, internet, and mail-order retailers; changes in consumer spending patterns, debt levels and their ability to meet credit obligations; adequate and stable availability of materials, production facilities and labor from which the Company sources its merchandise; changes in operating expenses, including employee wages, commission structures and related benefits; system failures or data security; possible future acquisitions of store properties from other department store operators; the continued availability of financing in amounts and at the terms necessary to support the Company’s future business; fluctuations in LIBOR and other base borrowing rates; potential disruption from terrorist activity and the effect on ongoing consumer confidence; epidemic, pandemic or other public health issues; potential disruption of international trade and supply chain efficiencies; world conflict and the possible impact on consumer spending patterns and other economic and demographic changes of similar or dissimilar nature.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

The table below provides information about the Company’s obligations that are sensitive to changes in interest rates. The table presents maturities of the Company’s long-term debt and Guaranteed Beneficial Interests in the Company’s Subordinated Debentures along with the related weighted-average interest rates by expected maturity dates.

<u>Expected Maturity Date (fiscal year)</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>Thereafter</u>	<u>Total</u>	<u>Fair Value</u>
	(in thousands of dollars)							
Long-term debt .....	\$196,446	\$24,653	\$837	\$56,667	\$56,376	\$621,632	\$956,611	\$835,833
Average fixed interest rate .....	6.5%	9.5%	9.3%	9.1%	7.9%	7.3%	7.3%	
Guaranteed Beneficial Interests in the								
Company’s Subordinated Debentures ....	\$ —	\$ —	\$ —	\$ —	\$ —	\$200,000	\$200,000	\$166,240
Average interest rate .....	— %	— %	— %	— %	— %	7.5%	7.5%	

The Company is exposed to market risk from changes in the interest rates under its \$1.2 billion revolving credit facility. Outstanding balances under this facility bear interest at a variable rate based on JPMorgan’s Base Rate minus 0.5% or LIBOR plus 1.0%. The Company had average borrowings of \$108.3 million during fiscal 2007. Based on the average amount outstanding during fiscal 2007, a 100 basis point change in interest rates would result in an approximate \$1.1 million annual change to interest expense.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

The consolidated financial statements of the Company and notes thereto are included in this report beginning on page F-1.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**ITEM 9A. CONTROLS AND PROCEDURES.**

The Company maintains “disclosure controls and procedures,” as such term is defined in Rules 13a-15e and 15d-15e of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), that are designed to ensure that information required to be disclosed in the Company’s reports, pursuant to the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to the Company’s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding the required disclosures. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well-designed and operated, can provide only reasonable assurances of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of February 2, 2008, the Company carried out an evaluation, with the participation of Company’s management, including William Dillard, II, Chairman of the Board of Directors and Chief Executive Officer (principal executive officer) and James I. Freeman, Senior Vice-President and Chief Financial Officer (principal financial officer), of the effectiveness of the Company’s “disclosure controls and procedures” pursuant to Securities Exchange Act Rule 13a-15. Based on their evaluation, the principal executive officer and principal financial officer concluded that the Company’s disclosure controls and procedures are effective at the reasonable assurance level.

Management’s report on internal control over financial reporting and the attestation report of Deloitte & Touche LLP, the Company’s independent registered public accounting firm, on management’s assessment of internal control over financial reporting is incorporated herein by reference from pages F-3 and F-4 of this report.

William Dillard, II, Chairman of the Board of Directors and Chief Executive Officer, has certified to the New York Stock Exchange that he is not aware of any violations by the Company of the exchange's corporate governance listing standards. Attached as an exhibit to this annual report is the certification of Mr. Dillard required under Section 302 of the Sarbanes-Oxley Act of 2002 regarding the quality of the Company's public disclosures.

***Changes in Internal Control over Financial Reporting***

Except for the implementation of a control over the calculation and review of equity earnings of CDI Contractors LLC, a 50%-owned, equity method joint venture investment of the Company that constructs stores for the Company, there were no changes in the Company's internal controls over financial reporting that occurred during the quarter ended February 2, 2008 to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION.**

None.

### PART III

#### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

##### A. Directors of the Registrant

Information regarding directors of the Registrant is incorporated herein by reference under the heading “Nominees for Election as Directors” and under the heading “Section 16(a) Beneficial Ownership Reporting Compliance” in the Proxy Statement.

##### B. Executive Officers of the Registrant

Information regarding executive officers of the Registrant is incorporated herein by reference to Part I of this report under the heading “Executive Officers of the Company.” Reference additionally is made to the information under the heading “Section 16(a) Beneficial Ownership Reporting Compliance” in the Proxy Statement, which information is incorporated herein by reference.

The Company’s Board of Directors has adopted a Company Code of Conduct that applies to all Company employees including the Company’s Directors, CEO and senior financial officers. The current version of such Code of Conduct is available free of charge on Dillard’s, Inc. website, [www.dillards.com](http://www.dillards.com), and is available in print to any shareholder who requests copies by contacting Julie J. Bull, Director of Investor Relations, at the Company’s principal executive offices set forth above.

#### ITEM 11. EXECUTIVE COMPENSATION.

Information regarding executive compensation and compensation of directors is incorporated herein by reference to the information beginning under the heading “Compensation of Directors and Executive Officers” and concluding under the heading “Compensation of Directors” in the Proxy Statement.

#### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

##### Equity Compensation Plan Information

	<u>Number of securities to be issued upon exercise of outstanding options</u>	<u>Weighted average exercise prices of outstanding options</u>	<u>Number of securities available for future issuance under equity compensation plans</u>
Equity compensation plans approved by shareholders . . . . .	<u>5,376,375</u>	<u>\$25.92</u>	<u>6,195,445</u>
Total . . . . .	<u>5,376,375</u>	<u>\$25.92</u>	<u>6,195,445</u>

Additional Information regarding security ownership of certain beneficial owners and management is incorporated herein by reference to the information under the heading “Principal Holders of Voting Securities” and under the heading “Security Ownership of Management” and continuing through footnote 12 in the Proxy Statement.

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

Information regarding certain relationships and related transactions is incorporated herein by reference to the information under the heading “Certain Relationships and Transactions” in the Proxy Statement.

#### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

Information regarding principal accountant fees and services is incorporated herein by reference to the information under the heading “Independent Accountant Fees” in the Proxy Statement.

## **PART IV**

### **ITEM 15. EXHIBITS.**

(a)(1) and (2) Financial Statements

An “Index of Financial Statements” has been filed as a part of this Report beginning on page F-1 hereof.

(a)(3) Exhibits and Management Compensatory Plans

An “Exhibit Index” has been filed as a part of this Report beginning on page E-1 hereof and is herein incorporated by reference.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DILLARD'S, INC.  
Registrant

/s/ JAMES I. FREEMAN

**James I. Freeman,  
Senior Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)**

Date: April 2, 2008

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacity and on the date indicated.

/s/ ROBERT C. CONNOR

**Robert C. Connor  
Director**

/s/ DRUE CORBUSIER

**Drue Corbusier  
Executive Vice President and Director**

/s/ WILL D. DAVIS

**Will D. Davis  
Director**

/s/ WILLIAM DILLARD, II

**William Dillard, II  
Chairman of the Board and  
Chief Executive Officer  
(Principal Executive Officer)**

/s/ ALEX DILLARD

**Alex Dillard  
President and Director**

/s/ MIKE DILLARD

**Mike Dillard  
Executive Vice President and Director**

/s/ JAMES I. FREEMAN

**James I. Freeman  
Senior Vice President and  
Chief Financial Officer and Director**

/s/ JOHN PAUL HAMMERSCHMIDT

**John Paul Hammerschmidt  
Director**

/s/ PETER R. JOHNSON

**Peter R. Johnson  
Director**

/s/ WARREN A. STEPHENS

**Warren A. Stephens  
Director**

/s/ WILLIAM H. SUTTON

**William H. Sutton  
Director**

/s/ J.C. WATTS, JR.

**J.C. Watts, Jr.  
Director**

Date: April 2, 2008





**INDEX OF FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE  
DILLARD’S, INC. AND SUBSIDIARIES  
Year Ended February 2, 2008**

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of Dillard's, Inc.  
Little Rock, Arkansas

We have audited the accompanying consolidated balance sheets of Dillard's, Inc. and subsidiaries (the "Company") as of February 2, 2008 and February 3, 2007, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended February 2, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Dillard's, Inc. and subsidiaries as of February 2, 2008 and February 3, 2007, and the results of their operations and their cash flows for each of the three years in the period ended February 2, 2008, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the Notes to Consolidated Financial Statements, (1) the Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, effective February 4, 2007, (2) the Company adopted Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, relating to the recognition and related disclosure provisions, effective February 3, 2007, and (3) the Company adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*, as revised, effective January 29, 2006.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of February 2, 2008, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 2, 2008 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Deloitte & Touche LLP  
New York, New York  
April 2, 2008

## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The financial statements, financial analysis and all other information in this Annual Report on Form 10-K were prepared by management, who is responsible for their integrity and objectivity and for establishing and maintaining adequate internal controls over financial reporting.

The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. The Company's internal control over financial reporting includes those policies and procedures that:

- i. pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets of the Company;
- ii. provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- iii. provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or dispositions of the Company's assets that could have a material effect on the financial statements.

There are inherent limitations in the effectiveness of any internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal controls can provide only reasonable assurances with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal controls may vary over time.

Management assessed the design and effectiveness of the Company's internal control over financial reporting as of February 2, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control—Integrated Framework*. Based on management's assessment using those criteria, it believes that, as of February 2, 2008, the Company's internal control over financial reporting is effective.

Deloitte & Touche LLP, an independent registered public accounting firm, has audited the financial statements of the Company for the fiscal years ended February 2, 2008, February 3, 2007, and January 28, 2006 and has attested to management's assertion regarding the effectiveness of the Company's internal control over financial reporting as of February 2, 2008. Their report is presented on the following page. The independent registered public accountants and internal auditors advise management of the results of their audits and make recommendations to improve the system of internal controls. Management evaluates the audit recommendations and takes appropriate action.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of Dillard's, Inc.  
Little Rock, Arkansas

We have audited Dillard's, Inc. and its subsidiaries' (the "Company's") internal control over financial reporting as of February 2, 2008 based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on that risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of February 2, 2008, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of February 2, 2008 and February 3, 2007 and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss) and cash flows for each of the three years in the period ended February 2, 2008 of the Company, and our report dated April 2, 2008

expressed an unqualified opinion and included an explanatory paragraph regarding the Company's adoption of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, effective February 4, 2007.

/s/ DELOITTE & TOUCHE LLP

Deloitte & Touche LLP  
New York, New York  
April 2, 2008

## CONSOLIDATED BALANCE SHEETS

	February 2, 2008	February 3, 2007
	(As restated, see Note 2)	
	Dollars in Thousands	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents .....	\$ 88,912	\$ 193,994
Accounts receivable .....	10,880	10,508
Merchandise inventories .....	1,779,279	1,772,150
Other current assets .....	66,117	71,194
Total current assets .....	1,945,188	2,047,846
Property and equipment:		
Land and land improvements .....	83,346	89,451
Buildings and leasehold improvements .....	3,117,292	2,931,244
Furniture, fixtures and equipment .....	1,969,343	2,160,190
Buildings under construction .....	96,057	56,856
Buildings and equipment under capital leases .....	48,910	48,910
Less accumulated depreciation and amortization .....	(2,124,504)	(2,140,025)
	3,190,444	3,146,626
Goodwill .....	31,912	34,511
Other assets .....	170,585	167,752
Total assets .....	\$ 5,338,129	\$ 5,396,735
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Trade accounts payable and accrued expenses .....	\$ 753,309	\$ 797,806
Current portion of long-term debt .....	196,446	100,635
Current portion of capital lease obligations .....	2,613	3,679
Other short-term borrowings .....	195,000	—
Federal and state income taxes including current deferred taxes .....	36,802	74,995
Total current liabilities .....	1,184,170	977,115
Long-term debt .....	760,165	956,611
Capital lease obligations .....	25,739	28,328
Other liabilities .....	217,403	206,122
Deferred income taxes .....	436,541	448,770
Operating leases and commitments		
Guaranteed preferred beneficial interests in the Company's subordinated debentures .....	200,000	200,000
Stockholders' equity:		
Common stock, Class A – 116,445,495 and 116,217,645 shares issued; 71,155,347 and 76,130,196 shares outstanding .....	1,165	1,162
Common stock, Class B (convertible) – 4,010,929 shares issued and outstanding .....	40	40
Additional paid-in capital .....	778,987	772,560
Accumulated other comprehensive loss .....	(22,211)	(21,229)
Retained earnings .....	2,680,690	2,640,224
Less treasury stock, at cost, Class A– 45,290,148 and 40,087,449 shares .....	(924,560)	(812,968)
Total stockholders' equity .....	2,514,111	2,579,789
Total liabilities and stockholders' equity .....	\$ 5,338,129	\$ 5,396,735

See notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended		
	February 2, 2008	February 3, 2007	January 28, 2006
	<b>Dollars in Thousands, Except Per Share Data</b>		
Net sales .....	\$7,207,417	\$7,636,056	\$7,551,697
Service charges and other income .....	163,389	174,011	142,948
	<u>7,370,806</u>	<u>7,810,067</u>	<u>7,694,645</u>
Cost of sales .....	4,786,655	5,032,351	5,014,021
Advertising, selling, administrative and general expenses .....	2,065,288	2,096,018	2,041,481
Depreciation and amortization .....	298,927	301,147	301,864
Rentals .....	59,987	55,480	47,538
Interest and debt expense, net .....	91,556	87,642	105,570
Gain on disposal of assets .....	(12,625)	(16,413)	(3,354)
Asset impairment and store closing charges .....	20,500	—	61,734
Income before income taxes and equity in earnings of joint ventures ...	<u>60,518</u>	<u>253,842</u>	<u>125,791</u>
Income taxes .....	13,010	20,580	14,300
Equity in earnings of joint ventures .....	6,253	12,384	9,994
Net income .....	<u>\$ 53,761</u>	<u>\$ 245,646</u>	<u>\$ 121,485</u>
Earnings per common share:			
Basic .....	\$ 0.69	\$ 3.09	\$ 1.49
Diluted .....	0.68	3.05	1.49

See notes to consolidated financial statements.

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND  
COMPREHENSIVE INCOME (LOSS)**

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehen- sive Loss	Retained Earnings	Treasury Stock	Total
	Class A	Class B					
			Dollars in	Thousands, Except Per Share Data			
Balance, January 29, 2005, as restated							
See Note 2	\$1,146	\$ 40	\$739,620	\$(13,333)	\$2,298,829	\$(708,769)	\$2,317,533
Net income	—	—	—	—	121,485	—	121,485
Minimum pension liability adjustment, net of tax of \$698	—	—	—	(1,241)	—	—	(1,241)
Total comprehensive income							120,244
Issuance of 655,858 shares under stock option plan	7	—	9,448	—	—	—	9,455
Purchase of 4,567,100 shares of treasury stock	—	—	—	—	—	(100,868)	(100,868)
Cash dividends declared: Common stock, \$0.16 per share	—	—	—	—	(12,987)	—	(12,987)
Balance, January 28, 2006, as restated							
See Note 2	1,153	40	749,068	(14,574)	2,407,327	(809,637)	2,333,377
Net income	—	—	—	—	245,646	—	245,646
Minimum pension liability adjustment, net of tax of \$153	—	—	—	266	—	—	266
Total comprehensive income							245,912
Adoption of FAS 158, net of tax of \$3,995				(6,921)			(6,921)
Issuance of 980,263 shares under stock option and stock bonus plans	9	—	23,492	—	—	—	23,501
Purchase of 133,500 shares of treasury stock	—	—	—	—	—	(3,331)	(3,331)
Cash dividends declared: Common stock, \$0.16 per share	—	—	—	—	(12,749)	—	(12,749)
Balance, February 3, 2007, as restated							
See Note 2	1,162	40	772,560	(21,229)	2,640,224	(812,968)	2,579,789
Net income	—	—	—	—	53,761	—	53,761
Change in unrecognized losses and prior service cost related to pension plans, net of tax of \$567	—	—	—	(982)	—	—	(982)
Total comprehensive income							52,779
Issuance of 227,850 shares under stock option and stock bonus plans	3	—	6,427	—	—	—	6,430
Purchase of 5,202,699 shares of treasury stock	—	—	—	—	—	(111,592)	(111,592)
Cumulative effect of accounting change related to adoption of FIN 48	—	—	—	—	(803)	—	(803)
Cash dividends declared: Common stock, \$0.16 per share	—	—	—	—	(12,492)	—	(12,492)
Balance, February 2, 2008	<u>\$1,165</u>	<u>\$ 40</u>	<u>\$778,987</u>	<u>\$(22,211)</u>	<u>\$2,680,690</u>	<u>\$(924,560)</u>	<u>\$2,514,111</u>

See notes to consolidated financial statements.



## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended		
	February 2, 2008	February 3, 2007	January 28, 2006
Dollars in Thousands			
Operating activities:			
Net income	\$ 53,761	\$ 245,646	\$ 121,485
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of property and deferred financing cost	300,859	303,256	304,376
Share-based compensation	77	1,002	—
Excess tax benefits from share-based compensation	(325)	(5,251)	—
Deferred income taxes	(2,399)	(32,807)	(32,862)
Gain on sale of joint venture	—	(13,810)	—
(Gain) loss on disposal of property and equipment	1,484	(2,603)	(3,354)
Asset impairment and store closing charges	20,500	—	61,734
Gain from hurricane insurance proceeds	(18,181)	—	(29,715)
Proceeds from hurricane insurance	5,881	—	83,398
Changes in operating assets and liabilities:			
(Increase) decrease in accounts receivable	(372)	2,015	(2,872)
(Increase) decrease in merchandise inventories	(7,129)	30,545	(123,345)
(Increase) decrease in other current assets	(7,366)	(60,283)	17,138
Increase in other assets	(4,243)	(2,421)	(6,201)
Decrease in trade accounts payable and accrued expenses, other liabilities and income taxes	(88,098)	(104,707)	(20,640)
Net cash provided by operating activities	<u>254,449</u>	<u>360,582</u>	<u>369,142</u>
Investing activities:			
Purchase of property and equipment	(396,337)	(320,640)	(456,078)
Proceeds from sale of property and equipment	48,249	6,479	103,637
Proceeds from hurricane insurance	16,101	27,826	26,708
Proceeds from sale of joint venture	—	19,990	—
Proceeds from sale of subsidiary	—	—	14,000
Return of capital from joint venture	—	—	14,125
Net cash used in investing activities	<u>(331,987)</u>	<u>(266,345)</u>	<u>(297,608)</u>
Financing activities:			
Principal payments on long-term debt and capital lease obligations	(104,291)	(205,907)	(163,919)
Payment on line of credit fees and expenses	(522)	(595)	(1,623)
Cash dividends paid	(12,492)	(12,749)	(12,987)
Proceeds from issuance of common stock	6,028	17,248	9,455
Excess tax benefits from share-based compensation	325	5,251	—
Purchase of treasury stock	(111,592)	(3,331)	(100,868)
Increase in short-term borrowings	195,000	—	—
Net cash used in financing activities	<u>(27,544)</u>	<u>(200,083)</u>	<u>(269,942)</u>
Decrease in cash and cash equivalents	(105,082)	(105,846)	(198,408)
Cash and cash equivalents, beginning of year	193,994	299,840	498,248
Cash and cash equivalents, end of year	<u>\$ 88,912</u>	<u>\$ 193,994</u>	<u>\$ 299,840</u>
Non-cash transactions:			
Tax benefit from exercise of stock options	\$ —	\$ —	\$ 3,683
Capital lease transactions	—	—	19,518
(Prepaid) accrued capital expenditures	(516)	10,052	23,351
Note received from sale of subsidiary	—	—	3,000

See notes to consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. Description of Business and Summary of Significant Accounting Policies

**Description of Business**—Dillard’s, Inc. (the “Company”) operates retail department stores located primarily in the Southeastern, Southwestern and Midwestern areas of the United States. The Company’s fiscal year ends on the Saturday nearest January 31 of each year. Fiscal years 2007, 2006 and 2005 ended on February 2, 2008, February 3, 2007 and January 28, 2006, respectively. Fiscal year 2006 included 53 weeks and fiscal years 2007 and 2005 included 52 weeks.

**Consolidation**—The accompanying consolidated financial statements include the accounts of Dillard’s, Inc. and its wholly owned subsidiaries. Intercompany accounts and transactions are eliminated in consolidation. Investments in and advances to joint ventures in which the Company has a 50% ownership interest are accounted for by the equity method.

**Use of Estimates**—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include inventories, sales return, self-insured accruals, future cash flows for impairment analysis, pension discount rate and taxes. Actual results could differ from those estimates.

**Seasonality**—The Company’s business is highly seasonal, and historically the Company has realized a significant portion of its sales, net income and cash flow in the second half of the fiscal year, attributable to the impact of the back-to-school selling season in the third quarter and the holiday selling season in the fourth quarter. Additionally, working capital requirements fluctuate during the year, increasing in the third quarter in anticipation of the holiday season.

**Guarantees**—The Company accounts for certain guarantees in accordance with FASB Interpretation No. 45, *Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others*, an Interpretation of FASB Statements No. 5, 57 and 107 and a Rescission of FASB Interpretation No. 34 (“FIN 45”). FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. FIN 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of certain obligations undertaken. The Company recognized a liability related to indebtedness incurred by certain joint ventures as of January 28, 2006. No guarantees existed as of February 2, 2008 or February 3, 2007.

**Cash Equivalents**—The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. The Company considers receivables from charge card companies as cash equivalents because they settle the balances within two to three days.

**Accounts Receivable**—Accounts receivable primarily consists of the monthly settlement with GE for Dillard’s share of revenue from the long-term marketing and servicing alliance.

**Merchandise Inventories**—The retail last-in, first-out (“LIFO”) inventory method is used to value merchandise inventories. At February 2, 2008 and February 3, 2007, the LIFO cost of merchandise was approximately equal to the first-in, first-out (“FIFO”) cost of merchandise.

**Property and Equipment**—Property and equipment owned by the Company is stated at cost, which includes related interest costs incurred during periods of construction, less accumulated depreciation and amortization. Capitalized interest was \$6.3 million, \$4.4 million and \$6.1 million in fiscal 2007, 2006 and 2005, respectively. For financial reporting purposes, depreciation is computed by the straight-line method over estimated useful lives:

Buildings and leasehold improvements . . . . .	20 - 40 years
Furniture, fixtures and equipment . . . . .	3 - 10 years

Properties leased by the Company under lease agreements which are determined to be capital leases are stated at an amount equal to the present value of the minimum lease payments during the lease term, less accumulated amortization. The properties under capital leases and leasehold improvements under operating leases are amortized on the straight-line method over the shorter of their useful lives or the related lease terms. The provision for amortization of leased properties is included in depreciation and amortization expense.

Included in property and equipment as of February 2, 2008 are assets held for sale in the amount of \$6.8 million. During fiscal 2007, the Company realized losses on the disposal of property and equipment of \$1.5 million. During fiscal 2006 and 2005, the Company realized gains on the disposal of property and equipment of \$2.6 million and \$3.4 million, respectively.

Depreciation expense on property and equipment was \$299 million, \$301 million and \$302 million for fiscal 2007, 2006 and 2005, respectively.

**Long-Lived Assets Excluding Goodwill**—The Company follows SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. In the evaluation of the fair value and future benefits of long-lived assets, the Company performs an analysis of the anticipated undiscounted future net cash flows of the related long-lived assets. This analysis is performed at the store unit level. If the carrying value of the related asset exceeds the undiscounted cash flows, the carrying value is reduced to its fair value which is based on real estate values or expected discounted future cash flows. Various factors including future sales growth and profit margins are included in this analysis. Management believes at this time that the carrying value and useful lives continue to be appropriate, after recognizing the impairment charges recorded in fiscal 2007 and 2005, as disclosed in Note 15.

**Goodwill**—The Company follows SFAS No. 142, *Goodwill and Other Intangible Assets*, which requires that goodwill be reviewed for impairment annually or more frequently if certain indicators arise. The Company tests for goodwill impairment annually as of the last day of the fourth quarter using the two-step process prescribed in SFAS No. 142. The Company identifies its reporting units under SFAS No. 142 at the store unit level. The fair value of these reporting units are estimated using the expected discounted future cash flows and market values of related businesses, where appropriate. Management believes at this time that the carrying value continues to be appropriate, recognizing the impairment charges recorded in fiscal 2007 and 2005 as disclosed in Notes 3 and 15.

**Other Assets**—Other assets include investments in joint ventures accounted for by the equity method. These joint ventures, which consist of malls and a general contracting company that constructs Dillard's stores and other commercial buildings, had carrying values of \$100 million and \$98 million at February 2, 2008 and February 3, 2007, respectively. The malls are located in Toledo, Ohio; Denver, Colorado and Bonita Springs, Florida. The Company received \$14.1 million as a return of capital from a joint venture during fiscal 2005. The Company recorded a \$13.8 million pretax gain during the year ended February 3, 2007 for the sale of its interest in the Yuma Palms joint venture for \$20.0 million.

**Vendor Allowances**—The Company receives concessions from its vendors through a variety of programs and arrangements, including cooperative advertising and margin maintenance programs. The Company has agreements in place with each vendor setting forth the specific conditions for each allowance or payment. These agreements range in periods from a few days to up to a year. If the payment is a reimbursement for costs incurred, it is offset against those related costs; otherwise, it is treated as a reduction to the cost of the merchandise.

For cooperative advertising programs, the Company generally offsets the allowances against the related advertising expense when incurred. Many of these programs require proof-of-advertising to be provided to the vendor to support the reimbursement of the incurred cost. Programs that do not require proof-of-advertising are

monitored to ensure that the allowance provided by each vendor is a reimbursement of costs incurred to advertise for that particular vendor. If the allowance exceeds the advertising costs incurred on a vendor-specific basis, then the excess allowance from the vendor is recorded as a reduction of merchandise cost for that vendor.

Margin maintenance allowances are credited directly to cost of purchased merchandise in the period earned according to the agreement with the vendor.

The accounting policies described above are in compliance with Emerging Issues Task Force 02-16, *Accounting by a Customer (Including a Reseller) for Certain Considerations Received from a Vendor*.

**Insurance Accruals**—The Company’s consolidated balance sheets include liabilities with respect to self-insured workers’ compensation and general liability claims. The Company estimates the required liability of such claims, utilizing an actuarial method, based upon various assumptions, which include, but are not limited to, our historical loss experience, projected loss development factors, actual payroll and other data. The required liability is also subject to adjustment in the future based upon the changes in claims experience, including changes in the number of incidents (frequency) and changes in the ultimate cost per incident (severity).

**Operating Leases**—The Company leases retail stores, office space and equipment under operating leases. Most store leases contain construction allowance reimbursements by landlords, rent holidays, rent escalation clauses and/or contingent rent provisions. The Company recognizes the related rental expense on a straight-line basis over the lease term and records the difference between the amounts charged to expense and the rent paid as a deferred rent liability.

To account for construction allowance reimbursements from landlords and rent holidays, the Company records a deferred rent liability included in trade accounts payable and accrued expenses and other liabilities on the consolidated balance sheets and amortizes the deferred rent over the lease term, as a reduction to rent expense on the consolidated income statements. For leases containing rent escalation clauses, the Company records minimum rent expense on a straight-line basis over the lease term on the consolidated income statement. The lease term used for lease evaluation includes renewal option periods only in instances in which the exercise of the option period can be reasonably assured and failure to exercise such options would result in an economic penalty.

**Revenue Recognition**—The Company recognizes revenue at the “point of sale.” Allowance for sales returns are recorded as a component of net sales in the period in which the related sales are recorded.

GE Consumer Finance (“GE”) owns and manages Dillard’s proprietary credit cards (“proprietary cards”) under a long-term marketing and servicing alliance (“alliance”) that expires in fiscal 2014. The Company’s share of income earned under the alliance with GE is included as a component of service charges and other income. The Company received income of approximately \$119 million, \$125 million and \$105 million from GE in fiscal 2007, 2006 and 2005, respectively. Further pursuant to this agreement, the Company has no continuing involvement other than to honor the proprietary cards in its stores. Although not obligated to a specific level of marketing commitment, the Company participates in the marketing of the proprietary cards and accepts payments on the proprietary cards in its stores as a convenience to customers who prefer to pay in person rather than by mailing their payments to GE. Amounts received for providing these services are included in the amounts disclosed above.

**Gift Card Revenue Recognition**—The Company establishes a liability upon the sale of a gift card. The liability is relieved and revenue is recognized when gift cards are redeemed for merchandise and for estimated breakage. The Company uses a homogeneous pool to recognize gift card breakage and will recognize income over the period when the likelihood of the gift card being redeemed is remote and the Company determines that it does not have a legal obligation to remit the value of unredeemed gift cards to the relevant jurisdiction as abandoned property. The Company determined gift card breakage income based upon historical redemption patterns. At that time, the Company will recognize breakage income over the performance period for those gift cards (i.e. 60 months). As of February 2, 2008 and February 3, 2007, gift card liabilities of \$76.9 million and \$74.9 million, respectively, were included in trade accounts payable and accrued expenses and other liabilities.

**Advertising**—Advertising and promotional costs, which include newspaper, television, radio and other media advertising, are expensed as incurred and were \$197 million, \$205 million and \$229 million, net of cooperative advertising reimbursements of \$67.1 million, \$67.1 million and \$57.8 million for fiscal years 2007, 2006 and 2005, respectively.

**Income Taxes**—Income taxes are accounted for in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (“SFAS No. 109”). Under SFAS No. 109, income taxes are recognized for the amount of taxes payable for the current year and deferred tax assets and liabilities for the future tax consequence of events that have been recognized differently in the financial statements than for tax purposes. Deferred tax assets and liabilities are established using statutory tax rates and are adjusted for tax rate changes. Effective at the beginning of the first quarter of fiscal 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (“FIN 48”). This interpretation clarifies the accounting for uncertainty in income tax recognized in an entity’s financial statements in accordance with SFAS No. 109. FIN 48 requires companies to determine whether it is “more likely than not” that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. For those tax positions where it is “not more likely than not” that a tax benefit will be sustained, no tax benefit is recognized. Where applicable, associated interest and penalties are also recorded.

**Shipping and Handling**—In accordance with Emerging Issues Task Force (“EITF”) 00-10, *Accounting for Shipping and Handling Fees and Costs*, the Company records shipping and handling reimbursements in Service Charges and Other Income. The Company records shipping and handling costs in cost of sales.

**Stock-Based Compensation**—On January 29, 2006, the first day of our 2006 fiscal year, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (“SFAS 123(R)”), a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*, as interpreted by SEC Staff Accounting Bulletin No. 107. Under SFAS 123(R), all forms of share-based payment to employees and directors, including stock options, must be treated as compensation and recognized in the income statement. Previous to the adoption of SFAS 123(R), the Company accounted for stock options under the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and, accordingly, did not recognize compensation expense in our consolidated financial statements.

**Retirement Benefit Plans**—The Company’s retirement benefit plan costs are accounted for using actuarial valuations required by SFAS No. 87, *Employers’ Accounting for Pensions*, and SFAS No. 106, *Employers’ Accounting for Postretirement Benefits Other Than Pensions*. The Company adopted SFAS No. 158, *Employer’s Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (“SFAS 158”) as of February 3, 2007. SFAS 158 requires an entity to recognize the funded status of its defined pension plans on the balance sheet and to recognize changes in the funded status that arise during the period but are not recognized as components of net periodic benefit cost, within other comprehensive income, net of income taxes.

**Equity in Earnings of Joint Ventures**—Equity in earnings of joint ventures includes the Company’s portion of the income or loss of the Company’s unconsolidated joint ventures.

**Segment Reporting**—The Company reports in a single operating segment—the operation of retail department stores. Revenues from customers are derived from merchandise. The Company does not rely on any major customers as a source of revenue. The Company purchases merchandise from many suppliers, none of which accounted for more than 5% of the Company’s net purchases during fiscal 2007.

The following table summarizes the percentage of net sales by each major product line:

	Percentage of Net Sales		
	Fiscal 2007	Fiscal 2006	Fiscal 2005
Cosmetics .....	15%	15%	15%
Ladies' Apparel and Accessories .....	37	36	36
Juniors' and Children's Apparel .....	9	10	10
Men's Apparel and Accessories .....	18	18	18
Shoes .....	13	13	12
Home and Other .....	8	8	9
Total .....	<u>100%</u>	<u>100%</u>	<u>100%</u>

### ***New Accounting Pronouncements***

In December 2007, the Financial Accounting Standards Board ("FASB") issued the Statement of Financial Accounting Standards ("SFAS") No. 141(R), *Business Combinations* ("SFAS 141(R)"). SFAS 141(R)'s objective is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after December 31, 2008. We expect that the adoption of SFAS 141(R) will not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued the SFAS No. 160, *Noncontrolling Interest in Consolidated Financial Statements* ("SFAS 160"). SFAS 160's objective is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 will be effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. We expect that the adoption of SFAS 160 will not have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115* ("SFAS 159"). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective at the beginning of an entity's first fiscal year that begins after November 15, 2007. We expect that the adoption of SFAS 159 will not have a material impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having concluded in those other accounting pronouncements that fair value is the relevant measurement attribute. This statement is effective for financial assets and liabilities in financial statements issued for fiscal years beginning after November 15, 2007. It is effective for non-financial assets and liabilities in financial statements issued for fiscal years beginning after November 15, 2008. We expect that the adoption of SFAS 157 will not have a material impact on our consolidated financial statements.

In December 2007, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") No. 110 to extend the use of "simplified method" for estimating the expected terms of "plain vanilla" employee stock options for the awards valuation. The method was initially allowed under SAB 107 in contemplation of the adoption of SFAS 123(R) to expense the compensation cost based on the awards grant date fair value. SAB 110 does not provide an expiration date for the use of the method. However, as more external information about exercise behavior will be available over time, it is expected that this method will not be used when more relevant information is available.

In February 2008, the FASB issued FSP SFAS 157-2, *Effective Date for FASB Statement No. 157*. This FSP permits the delayed application of SFAS 157 for all nonrecurring fair value measurements of nonfinancial assets and nonfinancial liabilities until fiscal years beginning after November 15, 2008. The Company has chosen to adopt SFAS 157 in accordance with the guidance of FSP SFAS 157-2 as stated above.

## 2. Restatement

Subsequent to the issuance of the Company's consolidated financial statements for the year ended February 3, 2007, the Company identified an error in accounting for its share of the equity in earnings of CDI Contractors LLC ("CDI"), a 50%-owned, equity method joint venture investment of the Company that is also a general contractor that constructs stores for the Company. In connection with a potential transfer of the other 50% shareholder's interest, the Company performed a review of CDI's internal financial records. During this review process, the Company discovered that CDI had recorded profit on the Company's construction projects in excess of what CDI had previously reported and which, therefore, was not properly eliminated. The cumulative impact on beginning retained earnings and stockholders' equity as of January 29, 2005 of this error was a decrease of \$7.2 million.

The following table reflects the effects of the restatement on the Statement of Stockholders' Equity as of January 28, 2006 (in thousands):

	<b>January 28, 2006</b>		
	<u>As Previously Reported</u>	<u>Restatement Adjustments</u>	<u>As Restated</u>
Retained earnings .....	\$2,414,491	\$(7,164)	\$2,407,327
Total stockholders' equity .....	2,340,541	(7,164)	2,333,377

The following table reflects the effects of the restatement on the Consolidated Balance Sheet and Statement of Stockholders' Equity as of February 3, 2007 (in thousands):

	<b>February 3, 2007</b>		
	<u>As Previously Reported</u>	<u>Restatement Adjustments</u>	<u>As Restated</u>
Property and equipment .....	\$3,157,906	\$(11,280)	\$3,146,626
Total assets .....	5,408,015	(11,280)	5,396,735
Deferred income taxes .....	452,886	(4,116)	448,770
Retained earnings .....	2,647,388	(7,164)	2,640,224
Total stockholders' equity .....	2,586,953	(7,164)	2,579,789
Total liabilities and stockholders' equity .....	5,408,015	(11,280)	5,396,735

The Company's net income for fiscal 2006 and 2005 was not materially impacted by this error; accordingly, a decrease of \$2.9 million to correct the effect of the error on fiscal 2006 and 2005 was recorded in fiscal 2007.

## 3. Goodwill

The changes in the carrying amount of goodwill for the years ended February 2, 2008 and February 3, 2007 are as follows (in thousands):

Goodwill balance at January 28, 2006 .....	\$34,511
Goodwill written off in fiscal 2006 .....	<u>—</u>
Goodwill balance at February 3, 2007 .....	\$34,511
Goodwill written off in fiscal 2007 .....	<u>(2,599)</u>
Goodwill balance at February 2, 2008 .....	<u>\$31,912</u>

The goodwill write-off of \$2.6 million during fiscal 2007 was for a store closed during the year where the projected cash flows were unable to sustain the amount of goodwill.

#### 4. Revolving Credit Agreement

At February 2, 2008, the Company maintained a \$1.2 billion revolving credit facility (“credit agreement”) with JPMorgan Chase Bank (“JPMorgan”) as agent for various banks, secured by the inventory of Dillard’s, Inc. operating subsidiaries. The credit agreement expires December 12, 2012. Borrowings under the credit agreement accrue interest at either JPMorgan’s Base Rate minus 0.5% or LIBOR plus 1.0% (4.14% at February 2, 2008) subject to certain availability thresholds as defined in the credit agreement. Availability for borrowings and letter of credit obligations under the credit agreement is limited to 85% of the inventory of certain Company subsidiaries (approximately \$1.0 billion at February 2, 2008). At February 2, 2008, borrowings of \$195 million were outstanding and letters of credit totaling \$72.5 million were issued under this credit agreement leaving unutilized availability under the facility of \$768 million. There are no financial covenant requirements under the credit agreement provided availability exceeds \$100 million. The Company pays an annual commitment fee to the banks of 0.25% of the committed amount less outstanding borrowings and letters of credit. The Company had weighted-average borrowings of \$108.3 million and \$10.6 million during fiscal 2007 and 2006, respectively.

#### 5. Long-Term Debt

Long-term debt consists of the following:

	<u>February 2, 2008</u>	<u>February 3, 2007</u>
	(in thousands of dollars)	
Unsecured notes		
At rates ranging from 6.30% to 9.50%, due 2008 through 2028 . . . . .	\$ 952,392	\$1,052,392
Mortgage note, payable monthly through 2013 and bearing interest at a rate of 9.25% . . . . .	4,219	4,854
	<u>956,611</u>	<u>1,057,246</u>
Current portion . . . . .	(196,446)	(100,635)
	<u>\$ 760,165</u>	<u>\$ 956,611</u>

There are no financial covenants under the debt agreements. Building, land, and land improvements with a carrying value of \$5.7 million at February 2, 2008 were pledged as collateral on the mortgage notes. Maturities of long-term debt over the next five years are \$196 million, \$25 million, \$1 million, \$57 million and \$56 million. Outstanding letters of credit aggregated \$72.5 million at February 2, 2008.

Net interest and debt expense consists of the following:

	<u>Fiscal 2007</u>	<u>Fiscal 2006</u>	<u>Fiscal 2005</u>
	(in thousands of dollars)		
Long-term debt:			
Interest . . . . .	\$82,037	\$ 99,644	\$104,003
Loss on early retirement of long-term debt . . . . .	—	—	478
Amortization of debt expense . . . . .	1,932	2,274	2,826
	<u>83,969</u>	<u>101,918</u>	<u>107,307</u>
Interest on capital lease obligations . . . . .	2,319	1,817	2,138
Revolving credit facility expenses . . . . .	9,387	3,721	3,442
Investment interest income . . . . .	(4,119)	(9,314)	(7,317)
Interest on income tax settlement . . . . .	—	(10,500)	—
	<u>\$91,556</u>	<u>\$ 87,642</u>	<u>\$105,570</u>

Interest paid during fiscal 2007, 2006 and 2005 was approximately \$96.2 million, \$123.3 million and \$113.7 million, respectively.



## 6. Trade Accounts Payable and Accrued Expenses

Trade accounts payable and accrued expenses consist of the following:

	<u>February 2, 2008</u>	<u>February 3, 2007</u>
	(in thousands of dollars)	
Trade accounts payable .....	\$565,215	\$581,908
Accrued expenses:		
Taxes, other than income .....	58,477	72,723
Salaries, wages, and employee benefits .....	46,248	58,386
Liability to customers .....	61,599	59,581
Interest .....	11,097	11,388
Rent .....	6,027	8,828
Other .....	4,646	4,992
	<u>\$753,309</u>	<u>\$797,806</u>

## 7. Income Taxes

The provision for federal and state income taxes is summarized as follows:

	<u>Fiscal 2007</u>	<u>Fiscal 2006</u>	<u>Fiscal 2005</u>
	(in thousands of dollars)		
Current:			
Federal .....	\$24,977	\$ 47,509	\$ 47,629
State .....	(9,568)	5,878	(467)
	<u>15,409</u>	<u>53,387</u>	<u>47,162</u>
Deferred:			
Federal .....	(4,914)	(35,338)	(39,290)
State .....	2,515	2,531	6,428
	<u>(2,399)</u>	<u>(32,807)</u>	<u>(32,862)</u>
	<u>\$13,010</u>	<u>\$ 20,580</u>	<u>\$ 14,300</u>

A reconciliation between the Company's income tax provision and income taxes using the federal statutory income tax rate is presented below:

	<u>Fiscal 2007</u>	<u>Fiscal 2006</u>	<u>Fiscal 2005</u>
	(in thousands of dollars)		
Income tax at the statutory federal rate (inclusive of equity in earnings of joint ventures) .....	\$23,370	\$ 93,179	\$ 47,525
State income taxes, net of federal benefit (inclusive of equity in earnings of joint ventures) .....	1,585	5,591	1,870
Net changes in FIN 48 liabilities /reserves .....	(5,867)	(57,236)	—
Tax benefit of federal credits .....	(3,340)	—	—
Nondeductible goodwill write off .....	933	—	344
Changes in cash surrender value of life insurance policies .....	(914)	—	—
Tax benefit of state restructuring .....	(1,331)	—	—
Changes in tax rate .....	—	3,451	5,469
Benefit of capital loss carrybacks .....	—	—	(45,415)
Changes in valuation allowance .....	(1,733)	(24,408)	—
Other .....	307	3	4,507
	<u>\$13,010</u>	<u>\$ 20,580</u>	<u>\$ 14,300</u>

During the year ended February 2, 2008, the Company recorded an income tax benefit relating to a net decrease in FIN 48 liabilities of approximately \$5.9 million, a recognition of tax benefits of approximately \$1.7 million for the change in a capital loss valuation allowance due to capital gain income, approximately \$1.3 million for a reduction in state tax liabilities due to a restructuring that occurred during this period and approximately \$3.3 million due to federal tax credits. In fiscal 2007, the Company achieved a settlement with a state taxing jurisdiction which necessitated changes in the FIN 48 liabilities.

During the year ended February 3, 2007, the Company recorded an income tax benefit relating to a \$57.2 million reduction of reserves for various federal and state tax contingencies, a \$3.5 million increase in deferred liabilities due to an increase in the state effective tax rate and a \$24.4 million tax benefit related to the decrease in a capital loss valuation allowance due to capital gain income. In fiscal 2006, the Company achieved a settlement with the Internal Revenue Service (“IRS”) concerning the issues raised in their examinations of the Company’s federal tax returns for fiscal years 1997 through 2002, thereby allowing the applicable statute of limitations for these periods to close prior to February 3, 2007. The settlement of these examinations necessitated changes in reserves and changes in capital loss valuation allowance due to capital gain income.

During the year ended January 28, 2006, income taxes included a \$5.8 million reduction of reserves for various federal and state tax contingencies, a \$10.4 million increase of reserves for various federal and state tax contingencies, a net \$5.5 million increase in deferred liabilities due to an increase in the state effective rate offset by a decrease reflecting the impact of tax law changes in the State of Ohio, and a \$45.4 million tax benefit related to the sale of a subsidiary of the Company.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company’s estimated federal and state income tax rate, inclusive of equity in earnings of joint ventures, was 19.5% in fiscal 2007, 7.7% in fiscal 2006 and 10.5% in fiscal 2005. Significant components of the Company’s deferred tax assets and liabilities as of February 2, 2008 and February 3, 2007 are as follows:

	<u>February 2, 2008</u>	<u>February 3, 2007</u>
	(in thousands of dollars)	
Property and equipment bases and depreciation differences . . . . .	\$ 522,718	\$ 516,431
Joint venture bases differences . . . . .	28,745	26,277
Differences between book and tax bases of inventory . . .	59,384	52,246
Other . . . . .	6,978	10,495
Total deferred tax liabilities . . . . .	<u>617,825</u>	<u>605,449</u>
Accruals not currently deductible . . . . .	(94,462)	(103,048)
Capital loss carryforwards . . . . .	(226,961)	(228,741)
Net operating loss carryforwards . . . . .	(161,795)	(155,792)
State income taxes . . . . .	(10,053)	—
Other . . . . .	(11,566)	(417)
Total deferred tax assets . . . . .	<u>(504,837)</u>	<u>(487,998)</u>
Capital loss valuation allowance . . . . .	226,961	228,741
Net operating loss valuation allowance . . . . .	129,574	126,297
Net deferred tax assets . . . . .	<u>(148,302)</u>	<u>(132,960)</u>
Net deferred tax liabilities . . . . .	<u>\$ 469,523</u>	<u>\$ 472,489</u>

At February 2, 2008, the Company had a deferred tax asset of approximately \$227 million related to a capital loss carryforward that could be utilized to reduce the tax liabilities of future years. This carryforward will expire in 2011. The deferred asset attributable to the capital loss carryforward has been reduced by a valuation allowance of \$227 million due to the uncertainty of future capital gains necessary to utilize the capital loss carryforward.

At February 2, 2008, the Company had a deferred tax asset related to state net operating loss carryforwards of approximately \$162 million that could be utilized to reduce the tax liabilities of future years. These carryforwards will expire between 2008 and 2028. A portion of the deferred asset attributable to state net operating loss carryforwards was reduced by a valuation allowance of approximately \$129.5 million for the losses of various members of the affiliated group in states that require separate company filings.

Deferred tax assets and liabilities are presented as follows in the accompanying consolidated balance sheets:

	<u>February 2, 2008</u>	<u>February 3, 2007</u>
	(in thousands of dollars)	
Net deferred tax liabilities-noncurrent .....	\$436,541	\$448,770
Net deferred tax liabilities-current .....	32,982	23,719
Net deferred tax liabilities .....	<u>\$469,523</u>	<u>\$472,489</u>

The Financial Accounting Standards Board issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109* (“FIN 48”) effective for fiscal years beginning after December 15, 2006. The Company adopted the new requirement as of February 4, 2007 with the cumulative effects recorded as an adjustment to retained earnings as of the beginning of the period of \$0.8 million. The Company classifies interest expense and penalties relating to income tax in the financial statements as income tax expense. The total amount of unrecognized tax benefits as of the date of adoption was \$27.6 million, of which \$17.8 million would, if recognized, affect the effective tax rate. The total amount of accrued interest and penalty as of the date of adoption was \$13.7 million. The total amount of unrecognized tax benefits as of February 2, 2008 was \$25.4 million, of which \$16.9 million would, if recognized, affect the effective tax rate. The total amount of accrued interest and penalties as of February 2, 2008 was \$8.8 million.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	<u>(in thousands of dollars)</u>
Unrecognized tax benefits at February 4, 2007 .....	\$ 27,639
Gross increases—tax positions in prior period .....	8,659
Gross decreases—tax positions in prior period .....	(10,372)
Gross increases—current period tax positions .....	2,083
Settlements .....	(2,538)
Lapse of statute of limitations .....	(56)
Unrecognized tax benefits at February 2, 2008 .....	<u>\$ 25,415</u>

The Company is currently being examined by the Internal Revenue Service for the fiscal tax years 2003 through 2005. The Company is also under examination by various state and local taxing jurisdictions for various fiscal years. The tax years that remain subject to examination for major tax jurisdictions are fiscal tax years 2003 and forward, with the exception of fiscal 1997 through 2002 amended state and local tax returns related to the reporting of federal audit adjustments.

The Company has taken positions in certain taxing jurisdictions for which it is reasonably possible that the total amounts of unrecognized tax benefits may decrease within the next twelve months. The possible decrease could result from the finalization of the Company’s federal and various state income tax audits. The Company’s federal income tax audit uncertainties primarily relate to research and development credits, while various state income tax audit uncertainties primarily relate to income from intangibles. The estimated range of the reasonably possible uncertain tax benefit decrease in the next twelve months is between \$1 million and \$5 million.

Income taxes paid during fiscal 2007, 2006 and 2005 were approximately \$69.8 million, \$110.1 million and \$98.7 million, respectively.

## **8. Guaranteed Preferred Beneficial Interests in the Company's Subordinated Debentures**

Guaranteed preferred beneficial interests in the Company's subordinated debentures are comprised of \$200 million liquidation amount of 7.5% Capital Securities, due August 1, 2038 (the "Capital Securities") representing beneficial ownership interest in the assets of Dillard's Capital Trust I, a consolidated entity of the Company.

Holders of the Capital Securities are entitled to receive cumulative cash distributions, payable quarterly, at the annual rate of 7.5% of the liquidation amount of \$25 per Capital Security. The subordinated debentures are the sole assets of the Trust, and the Capital Securities are subject to mandatory redemption upon repayment of the subordinated debentures. The Company's obligations under the debentures and related agreements, taken together, provides a full and unconditional guarantee of payments due on the Capital Securities.

## **9. Benefit Plans**

The Company has a retirement plan with a 401(k)-salary deferral feature for eligible employees. Under the terms of the plan, eligible employees may contribute up to the lesser of \$15,500 (\$20,500 if at least 50 years of age) or 75% of eligible pay. Eligible employees with one year of service, who elect to participate in the plan, receive a Company matching contribution. Company matching contributions are calculated on the eligible employee's first 6% of elective deferrals with the first 1% being matched 100% and the next 5% being matched 50%. The Company matching contributions are used to purchase Class A Common Stock of the Company for the benefit of the employee. The terms of the plan provide a two-year vesting schedule for the Company matching contribution portion of the plan. The Company incurred benefit plan expense of \$14 million, \$13 million and \$13 million for fiscal 2007, 2006 and 2005, respectively.

The Company has a nonqualified defined benefit plan for its officers. The plan is noncontributory and provides benefits based on years of service and compensation during employment. Pension expense is determined using various actuarial cost methods to estimate the total benefits ultimately payable and allocates this cost to service periods. The pension plan is unfunded. The actuarial assumptions used to calculate pension costs are reviewed annually.

The Company's retirement benefit plan costs are accounted for using actuarial valuations required by SFAS No. 87, *Employers' Accounting for Pensions* and SFAS No. 158, *Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ("SFAS 158"). SFAS 158 requires an entity to recognize the funded status of its defined pension benefit plan on the balance sheet and to recognize changes in the funded status, that arise during the period but are not recognized as components of net periodic benefit cost, within accumulated other comprehensive loss, net of income taxes.

The accumulated benefit obligations (“ABO”), change in projected benefit obligation (“PBO”), change in plan assets, funded status, and reconciliation to amounts recognized in the consolidated balance sheets are as follows:

	<u>February 2, 2008</u>	<u>February 3, 2007</u>
	(in thousands of dollars)	
Change in benefit obligation:		
Benefit obligation at beginning of year .....	\$ 105,025	\$ 98,884
Service cost .....	2,069	2,181
Interest cost .....	6,002	5,396
Actuarial loss .....	4,246	2,224
Benefits paid .....	<u>(3,627)</u>	<u>(3,660)</u>
Benefit obligation at end of year .....	<u>\$ 113,715</u>	<u>\$ 105,025</u>
Change in plan assets:		
Fair value of plan assets at beginning of year .....	\$ —	\$ —
Employer contribution .....	3,627	3,660
Benefits paid .....	<u>(3,627)</u>	<u>(3,660)</u>
Fair value of plan assets at end of year .....	<u>\$ —</u>	<u>\$ —</u>
Funded status (benefit obligation less plan assets) .....	<u>\$(113,715)</u>	<u>\$(105,025)</u>
Unamortized prior service costs .....	—	—
Unrecognized net actuarial loss .....	—	—
Intangible asset .....	—	—
Unrecognized net loss .....	<u>—</u>	<u>—</u>
Accrued benefit cost .....	<u>\$(113,715)</u>	<u>\$(105,025)</u>
Benefit obligation in excess of plan assets .....	<u>\$(113,715)</u>	<u>\$(105,025)</u>
Amounts recognized in the balance sheets:		
Accrued benefit liability .....	\$(113,715)	\$(105,025)
Intangible asset .....	—	—
Accumulated other comprehensive loss .....	<u>—</u>	<u>—</u>
Net amount recognized .....	<u>\$(113,715)</u>	<u>\$(105,025)</u>
Accumulated benefit obligation at end of year .....	<u>\$(103,948)</u>	<u>\$ (97,211)</u>

Accrued benefit liability is included in other liabilities. Accumulated other comprehensive loss, net of tax benefit, is included in stockholders’ equity.

The estimated actuarial loss and prior service cost for the nonqualified defined benefit plans that will be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year approximate \$2 million and \$600 thousand, respectively.

Pretax amounts recognized in accumulated other comprehensive loss for fiscal 2007 consisted of net actuarial losses and prior service cost of \$31.6 million and \$3.2 million, respectively. The pretax amounts recognized in accumulated other comprehensive loss for fiscal 2006 consisted of net actuarial losses and prior service cost of \$29.4 million and \$3.9 million, respectively. The pretax amounts recognized in accumulated other comprehensive loss for fiscal 2005 consisted of net actuarial losses of \$22.8 million.

The discount rate that the Company utilizes for determining future pension obligations is based on the Citigroup High Grade Corporate Yield Curve on its annual measurement date as of the end of each fiscal year

and is matched to the future expected cash flows of the benefit plans by annual periods. The discount rate determined on this basis had increased to 6.3% as of February 2, 2008 from 5.9% as of February 3, 2007. Weighted average assumptions are as follows:

	<u>Fiscal 2007</u>	<u>Fiscal 2006</u>	<u>Fiscal 2005</u>
Discount rate-net periodic pension cost .....	5.90%	5.60%	5.50%
Discount rate-benefit obligations .....	6.30%	5.90%	5.60%
Rate of compensation increases .....	4.00%	4.00%	4.00%

The components of net periodic benefit costs are as follows:

	<u>Fiscal 2007</u>	<u>Fiscal 2006</u>	<u>Fiscal 2005</u>
(in thousands of dollars)			
Components of net periodic benefit costs:			
Service cost .....	\$ 2,069	\$ 2,181	\$1,993
Interest cost .....	6,002	5,396	4,756
Net actuarial gain (loss) .....	2,070	2,016	1,570
Amortization of prior service cost .....	626	627	627
Net periodic benefit costs .....	<u>\$10,767</u>	<u>\$10,220</u>	<u>\$8,946</u>

The estimated future benefits payments for the nonqualified benefit plan are as follows:

	<u>(in thousands of dollars)</u>
Fiscal Year	
2008 .....	\$ 3,961
2009 .....	5,244
2010 .....	5,010
2011 .....	4,896
2012 .....	5,554
2013-2017 .....	<u>33,435</u>
Total payments for next ten fiscal years .....	<u>\$58,100</u>

## 10. Stockholders' Equity

Capital stock is comprised of the following:

<u>Type</u>	<u>Par Value</u>	<u>Shares Authorized</u>
Preferred (5% cumulative) .....	\$100.00	5,000
Additional preferred .....	\$ 0.01	10,000,000
Class A, common .....	\$ 0.01	289,000,000
Class B, common .....	\$ 0.01	11,000,000

Holders of Class A are empowered as a class to elect one-third of the members of the Board of Directors, and the holders of Class B are empowered as a class to elect two-thirds of the members of the Board of Directors. Shares of Class B are convertible at the option of any holder thereof into shares of Class A at the rate of one share of Class B for one share of Class A.

On March 2, 2002, the Company adopted a shareholder rights plan under which the Board of Directors declared a dividend of one preferred share purchase right for each outstanding share of the Company's Common Stock, which includes both the Company's Class A and Class B Common Stock, payable on March 18, 2002 to

the shareholders of record on that date. Each right, which is not presently exercisable, entitles the holder to purchase one one-thousandth of a share of Series A Junior Participating Preferred Stock for \$70 per one one-thousandth of a share of Preferred Stock, subject to adjustment. In the event that any person acquires 15% or more of the outstanding shares of common stock, each holder of a right (other than the acquiring person or group) will be entitled to receive, upon payment of the exercise price, shares of Class A common stock having a market value of two times the exercise price. The rights will expire, unless extended, redeemed or exchanged by the Company, on March 2, 2012.

### *Share Repurchase Programs*

#### **2007 Plan**

In November 2007, the Company's board of directors authorized a new share repurchase plan under which the Company may repurchase up to \$200 million of its Class A common stock. The new open-ended authorization permits the Company to repurchase its Class A common stock in the open market or through privately negotiated transactions. No repurchases have been made under this plan as of February 2, 2008.

#### **2005 Plan**

During 2005, the Company repurchased 3.9 million shares for \$85 million under the 2005 stock repurchase plan ("2005 plan") which was approved by the board of directors in May 2005 and authorized the repurchase of up to \$200 million of its Class A Common Stock. During 2006, the Company repurchased 133,500 shares for \$3 million under the 2005 plan. During 2007, the Company repurchased 5.2 million shares under the 2005 plan for \$112 million which completed the authorization under this plan.

#### **2000 Plan**

During 2005, the Company repurchased approximately 665,000 shares for \$16 million, which completed the remaining authorized repurchase of Class A Common Stock under the Company's \$200 million program approved by the board of directors in May of 2000.

## **11. Earnings per Share**

In accordance with SFAS No. 128, *Earnings Per Share*, basic earnings per share has been computed based upon the weighted average of Class A and Class B common shares outstanding. Diluted earnings per share gives effect to outstanding stock options.

Earnings per common share has been computed as follows:

	Fiscal 2007		Fiscal 2006		Fiscal 2005	
	Basic	Diluted	Basic	Diluted	Basic	Diluted
	(in thousands of dollars, except per share data)					
Net earnings available for per-share calculation .....	\$53,761	\$53,761	\$245,646	\$245,646	\$121,485	\$121,485
Average shares of common stock outstanding .....	78,406	78,406	79,603	79,603	81,504	81,504
Stock options .....	—	697	—	872	—	157
Total average equivalent shares .....	78,406	79,103	79,603	80,475	81,504	81,661
Per Share of Common Stock:						
Net income .....	\$ 0.69	\$ 0.68	\$ 3.09	\$ 3.05	\$ 1.49	\$ 1.49

Total stock options outstanding were 5,376,375, 5,915,269 and 8,319,953 at February 2, 2008, February 3, 2007, and January 28, 2006, respectively. Of these, options to purchase 5,376,375 and 4,548,816 shares of Class A Common Stock at prices ranging from \$24.01 to \$30.47 and \$24.01 to \$29.99 per share were outstanding in fiscal 2007 and fiscal 2005, respectively, but were not included in the computation of diluted earnings per share because the exercise price of the options exceeds the average market price and would have been antidilutive. No options outstanding were excluded in the computation of diluted earnings per share for fiscal 2006 as none were antidilutive.

## 12. Stock Options

The Company has various stock option plans that provide for the granting of options to purchase shares of Class A Common Stock to certain key employees of the Company. Exercise and vesting terms for options granted under the plans are determined at each grant date. All options were granted at not less than fair market value at dates of grant. At the end of fiscal 2007, 6,195,445 shares were available for grant under the plans and 11,571,820 shares of Class A Common Stock were reserved for issuance under the stock option plans.

Upon adoption of SFAS No. 123(R) as of January 29, 2006, the Company elected to continue to value its share-based payment transactions using a Black-Scholes option pricing model, which was previously used by the Company for purposes of preparing the pro forma disclosures under SFAS No. 123. Under the provisions of SFAS No. 123(R), stock-based compensation expense recognized during the period is based on the portion of the share-based payment awards that are ultimately expected to vest. Accordingly, stock-based compensation expense recognized in fiscal 2007 and fiscal 2006 has been reduced for estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Compensation expense for stock option awards granted on or after January 29, 2006 will be expensed using a straight-line single option method, which is the same attribution method that was used by the Company for purposes of its pro forma disclosures under SFAS No. 123.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to options granted under the Company's stock option plans in all periods presented. For purposes of this pro forma disclosure, the value of options is estimated using the Black-Scholes option-pricing model and amortized to expense over the options' vesting periods.

	<u>Fiscal 2005</u> (in thousands of dollars, except per share data)
Net income:	
As reported .....	\$121,485
Add: Total stock bonus expense, net of tax .....	1,716
Add: Stock-based employee compensation expense included in reported net income, net of tax .....	—
Deduct: Total stock-based employee compensation expense determined under fair value based method, net of tax .....	(32,421)
Deduct: Total stock bonus expense, net of tax .....	(1,716)
Pro forma .....	<u>\$ 89,064</u>
Basic earnings per share:	
As reported .....	\$ 1.49
Pro forma .....	1.09
Diluted earnings per share:	
As reported .....	\$ 1.49
Pro forma .....	1.09



The fair value of each option grant is estimated on the date of each grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	<u>Fiscal 2007</u>	<u>Fiscal 2006</u>	<u>Fiscal 2005</u>
Risk-free interest rate .....	—	—	4.30%
Expected option life (years) .....	—	—	5.0
Expected volatility .....	—	—	42.3%
Expected dividend yield .....	—	—	0.62%

There were no stock options granted during fiscal 2007 and 2006. The fair values generated by the Black-Scholes model may not be indicative of the future benefit, if any, that may be received by the option holder.

Stock option transactions are summarized as follows:

	<u>Fiscal 2007</u>	
	<u>Shares</u>	<u>Weighted Average Exercise Price</u>
<b><u>Fixed Options</u></b>		
Outstanding, beginning of year .....	5,915,269	\$25.88
Granted .....	—	—
Exercised .....	(179,575)	24.35
Forfeited .....	(359,319)	26.12
Outstanding, end of year .....	<u>5,376,375</u>	<u>\$25.92</u>
Options exercisable at year-end .....	<u>5,356,375</u>	<u>\$25.92</u>
Weighted-average fair value of options granted during the year .....	\$ —	

The following table summarizes information about stock options outstanding at February 2, 2008:

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>		<u>Options Exercisable</u>		
	<u>Options Outstanding</u>	<u>Weighted-Average Remaining Contractual Life (Yrs.)</u>	<u>Weighted-Average Exercise Price</u>	<u>Options Exercisable</u>	<u>Weighted-Average Exercise Price</u>
\$24.01 - \$24.73 .....	98,781	1.76	\$24.18	78,781	\$24.23
\$25.74 - \$25.74 .....	3,925,000	7.98	25.74	3,925,000	25.74
\$25.95 - \$30.47 .....	1,352,594	1.80	26.55	1,352,594	26.55
	<u>5,376,375</u>	<u>6.31</u>	<u>\$25.92</u>	<u>5,356,375</u>	<u>\$25.92</u>

The intrinsic value of stock options exercised during the years ended February 2, 2008, February 3, 2007 and January 28, 2006 was approximately \$1.8 million, \$14.4 million and \$10.2 million, respectively. At February 2, 2008, the intrinsic value of outstanding stock options and exercisable stock options was \$0.

The Company had non-vested options outstanding of 20,000 shares as of February 2, 2008. The non-vested options outstanding as of February 2, 2008 had a weighted-average grant date fair value of \$10.05 per share. All options exercised are issued out of authorized shares.

### 13. Leases and Commitments

Rental expense consists of the following:

	<u>Fiscal 2007</u>	<u>Fiscal 2006</u>	<u>Fiscal 2005</u>
	(in thousands of dollars)		
Operating leases:			
Buildings:			
Minimum rentals .....	\$25,798	\$29,640	\$30,611
Contingent rentals .....	5,997	6,558	6,775
Equipment .....	28,192	19,282	10,152
	<u>\$59,987</u>	<u>\$55,480</u>	<u>\$47,538</u>

Contingent rentals on certain leases are based on a percentage of annual sales in excess of specified amounts. Other contingent rentals are based entirely on a percentage of sales.

The future minimum rental commitments as of February 2, 2008 for all noncancelable leases for buildings and equipment are as follows:

<u>Fiscal Year</u>	<u>Operating Leases</u>	<u>Capital Leases</u>
	(in thousands of dollars)	
2008 .....	56,065	4,684
2009 .....	50,014	3,628
2010 .....	37,325	3,569
2011 .....	45,026	3,509
2012 .....	34,118	13,787
After 2012 .....	<u>33,143</u>	<u>12,066</u>
Total minimum lease payments .....	<u>\$255,691</u>	41,243
Less amount representing interest .....		<u>(12,892)</u>
Present value of net minimum lease payments (of which \$2,613 is currently payable) .....		<u>\$ 28,351</u>

Renewal options from three to 25 years exist on the majority of leased properties. At February 2, 2008, the Company is committed to incur costs of approximately \$153 million to acquire, complete and furnish certain stores and equipment.

During 2005, the Company sold and leased back certain corporate aircraft resulting in proceeds of \$59.4 million. These leases, which are accounted for under SFAS No. 13, *Accounting for Leases*, are classified as either operating or capital, as appropriate, and are included in the tables above. The leases have seven-year terms. The Company recorded a capital lease obligation of \$17.2 million related to certain aircraft noted above. The remaining leases were recorded as operating leases and included in rent expense.

During 2005, the Company completed the disposition of all of the outstanding capital stock of an indirect wholly-owned subsidiary of the Company. The proceeds from the sale consist of \$14 million in cash and a \$3 million promissory note. In connection with the transaction, various subsidiaries of the Company entered into an operating lease agreement with the purchaser whereby they agreed to lease each of the properties for a term of 20 years. The minimum future payments under the lease are \$58 thousand per month and are included in the table above.

We were a member of a class of a settled lawsuit against Visa U.S.A. Inc. (“Visa”) and MasterCard International Incorporated (“MasterCard”). The Visa Check/MasterMoney Antitrust litigation settlement became final on June 1, 2005. The settlement provided \$3.05 billion in compensatory relief by Visa and MasterCard to be funded over a fixed period of time to respective Settlement Funds. We received and recorded \$6.5 million (\$4.0 million after tax) as our share of the proceeds from the settlement during year ended February 3, 2007. This amount was recorded in service charges and other income.

On July 29, 2002, a Class Action Complaint (followed on December 13, 2004 by a Second Amended Class Action Complaint) was filed in the United States District Court for the Southern District of Ohio against the Company, the Mercantile Stores Pension Plan (the “Plan”) and the Mercantile Stores Pension Committee (the “Committee”) on behalf of a putative class of former Plan participants. The complaint alleged that certain actions by the Plan and the Committee violated the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), as a result of amendments made to the Plan that allegedly were either improper and/or ineffective and as a result of certain payments made to certain beneficiaries of the Plan that allegedly were improperly calculated and/or discriminatory on account of age. The Second Amended Complaint did not specify any liquidated amount of damages sought and sought recalculation of certain benefits paid to putative class members.

During fiscal 2006, the Company signed a memorandum of understanding and recorded additional expense of \$21.7 million in SG&A to settle the case. The settlement became final in early April 2007. During the year ended February 2, 2008, the Company paid this settlement. The litigation continues between the Company and the Plan’s actuarial firm over the Company’s cross claim against the actuarial firm seeking reimbursement for the settlement and additional damages.

Various other legal proceedings, in the form of lawsuits and claims, which occur in the normal course of business, are pending against the Company and its subsidiaries. In the opinion of management, disposition of these matters is not expected to materially affect the Company's financial position, cash flows or results of operations.

#### **14. Insurance Proceeds**

During the year ended January 28, 2006, Hurricane Katrina, Hurricane Rita and Hurricane Wilma interrupted operations in approximately 60 of the Company’s stores for varying amounts of time. Ten stores suffered damage to either merchandise or property related to the hurricanes. One store in the New Orleans area was permanently closed. A store in Biloxi, Mississippi was closed throughout the remainder of fiscal 2005 and remained closed for clean-up and reconstruction until its re-opening in March 2008.

Property and merchandise losses in the affected stores were covered by insurance. Insurance proceeds of \$22.0 million, \$27.8 million and \$110.1 million were received during fiscal 2007, 2006 and 2005, respectively. The Company recorded related gains in fiscal 2007 of \$14.1 million and \$4.1 million in gain on disposal of assets and cost of sales, respectively. The Company recorded a related gain of \$29.7 million in 2005 in cost of sales.

#### **15. Asset Impairment and Store Closing Charges**

During fiscal 2007, the Company recorded a pretax charge of \$20.5 million for asset impairment and store closing costs. The charge consists of a write-off of goodwill on one store of \$2.6 million, an accrual for future rent, property tax and utility payments on two stores of \$1.0 million and a write-down of property and equipment on 14 stores for \$16.9 million.

There were no asset impairment and store closing charges for fiscal 2006.

During fiscal 2005, the Company recorded a pretax charge of \$61.7 million for asset impairment and store closing costs. Included in asset impairment and store closing charges is a pretax loss on the disposition of all the

outstanding capital stock of an indirect wholly-owned subsidiary in the amount of \$40.1 million. The charge also consists of a write-down of goodwill on one store of \$1.0 million, an accrual for future rent, property tax and utility payments on four stores of \$3.7 million and a write-down of property and equipment on nine stores in the amount of \$16.9 million

A breakdown of the asset impairment and store closing charges follows:

	Fiscal 2007		Fiscal 2006		Fiscal 2005	
	Number of Locations	Impairment Amount	Number of Locations	Impairment Amount	Number of Locations	Impairment Amount
	(in thousands of dollars)					
Stores closed in previous fiscal year . . . .	1	\$ 687	—	\$—	—	\$ —
Stores closed in current fiscal year . . . . .	4	3,647	—	—	5	8,729
Stores to close in next fiscal year . . . . .	5	5,083	—	—	—	—
Stores impaired based on cash flows . . . .	6	9,113	—	—	9	12,899
Wholly-owned subsidiary . . . . .	—	—	—	—	7	40,106
Non-operating facility . . . . .	1	1,970	—	—	—	—
Total . . . . .	<u>17</u>	<u>\$20,500</u>	<u>—</u>	<u>\$—</u>	<u>21</u>	<u>\$61,734</u>

Following is a summary of the activity in the reserve established for asset impairment and store closing charges:

	Balance, beginning of year	Charges	Cash Payments	Balance, end of year
	(in thousands of dollars)			
Fiscal 2007				
Rent, property taxes and utilities . . . . .	\$3,406	\$1,100	\$1,726	\$2,780
Fiscal 2006				
Rent, property taxes and utilities . . . . .	4,281	—	875	3,406
Fiscal 2005				
Rent, property taxes and utilities . . . . .	2,905	3,703	2,327	4,281

The reserve is recorded in trade accounts payable and accrued expenses and other liabilities

## 16. Fair Value Disclosures

The estimated fair values of financial instruments which are presented herein have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of amounts the Company could realize in a current market exchange.

The fair value of the Company's long-term debt and guaranteed preferred beneficial interests in the Company's subordinated debentures is based on market prices or dealer quotes (for publicly traded unsecured notes) and on discounted future cash flows using current interest rates for financial instruments with similar characteristics and maturity (for bank notes and mortgage notes).

The fair value of the Company's cash and cash equivalents and trade accounts receivable approximates their carrying values at February 2, 2008 and February 3, 2007 due to the short-term maturities of these instruments. The fair values of the Company's long-term debt at February 2, 2008 and February 3, 2007 were \$835 million and \$1.06 billion, respectively. The carrying value of the Company's long-term debt at February 2, 2008 and

February 3, 2007 was \$957 million and \$1.06 billion, respectively. The fair value of the guaranteed preferred beneficial interests in the Company's subordinated debentures at February 2, 2008 and February 3, 2007 was \$166 million and \$198 million, respectively. The carrying value of the guaranteed preferred beneficial interests in the Company's subordinated debentures at February 2, 2008 and February 3, 2007 was \$200 million.

## 17. Quarterly Results of Operations (unaudited)

	Fiscal 2007, Three Months Ended			
	May 5	August 4	November 3	February 2
	(in thousands of dollars, except per share data)			
Net sales	\$1,762,954	\$1,648,533	\$1,633,443	\$2,162,487
Gross profit	636,863	519,854	562,782	701,263
Net income (loss)	42,924	(25,166)	(11,341)	47,344
Diluted earnings per share:				
Net income (loss)	\$ 0.53	\$ (0.31)	\$ (0.15)	\$ 0.63

	Fiscal 2006, Three Months Ended			
	April 29	July 29	October 28	February 3
	(in thousands of dollars, except per share data)			
Net sales	\$1,835,309	\$1,685,477	\$1,719,321	\$2,395,949
Gross profit	655,872	563,204	601,008	783,621
Net income	61,319	15,727	13,609	154,991
Diluted earnings per share:				
Net income	\$ 0.77	\$ 0.20	\$ 0.17	\$ 1.90

Total of quarterly earnings per common share may not equal the annual amount because net income per common share is calculated independently for each quarter.

Quarterly information for fiscal 2007 and fiscal 2006 includes the following items:

### First Quarter

#### 2007

- a \$4.1 million pretax gain (\$2.6 million after tax or \$0.03 per diluted share) related to reimbursement for inventory damages incurred during the 2005 hurricane season.

### Second Quarter

#### 2007

- a \$3.1 million pretax gain (\$1.9 million after tax or \$0.02 per diluted share) related to reimbursement for inventory and property damages incurred during the 2005 hurricane season.

#### 2006

- a \$13.5 million pretax gain (\$8.5 million after tax or \$0.11 per diluted share) on the sale of the Company's interest in a mall joint venture.
- a \$6.5 million pretax gain (\$4.0 million after tax or \$0.05 per diluted share) related to proceeds received from the Visa Check/Mastermoney Antitrust litigation.
- a \$21.7 million pretax charge (\$13.6 million after tax or \$0.17 per diluted share) for a memorandum of understanding reached in a litigation case.

- a \$5.8 million income tax benefit (\$0.07 per diluted share) for the change in a capital loss valuation allowance due to capital gain income and \$6.5 million income tax benefit (\$0.08 per diluted share) due to the release of tax reserves.

### **Third Quarter**

#### **2007**

- a \$3.7 million pretax charge (\$2.3 million after tax or \$0.03 per diluted share) for asset impairment and store closing charges related to a future lease obligation on a store closed during the third quarter of 2007 and the write-off of goodwill for a store planned to close during the fourth quarter of 2007.
- an \$11.1 million pretax gain (\$7.0 million after tax or \$0.09 per diluted share) related to reimbursement for property damages incurred during the 2005 hurricane season as the Company completed the cleanup of the damaged location during the year.

### **Fourth Quarter**

#### **2007**

- a \$16.1 million pretax charge (\$10.1 million after tax or \$0.13 per diluted share) for asset impairment and store closing charges related to certain stores.
- a \$10.3 million income tax benefit (\$0.14 per diluted share) primarily due to state administrative settlement, federal credits and the change in a capital loss valuation allowance.

#### **2006**

- a \$10.5 million pretax interest credit (\$6.6 million after tax or \$0.08 per diluted share) and a net income tax benefit of \$64.0 million (\$0.80 per diluted share) which includes \$18.3 million for the change in a capital loss valuation allowance. Both the pretax interest credit and the income tax benefit are related to statute expirations and audit settlements with federal and state authorities for multiple tax years.

## EXHIBIT INDEX

<u>Number</u>	<u>Description</u>
*3(a)	Restated Certificate of Incorporation (Exhibit 3 to Form 10-Q for the quarter ended August 1, 1992 in 1-6140).
*3(b)	By-Laws as currently in effect (Exhibit 4.2 to Form S-8 filed November 27, 2007 in 333-147636).
*4(a)	Indenture between the Registrant and Chemical Bank, Trustee, dated as of October 1, 1985 (Exhibit (4) in 2-85556).
*4(b)	Indenture between the Registrant and Chemical Bank, Trustee, dated as of October 1, 1986 (Exhibit (4) in 33-8859).
*4(c)	Indenture between Registrant and Chemical Bank, Trustee, dated as of April 15, 1987 (Exhibit 4.3 in 33-13534).
*4(d)	Indenture between Registrant and Chemical Bank, Trustee, dated as of May 15, 1988, as supplemented (Exhibit 4 in 33-21671, Exhibit 4.2 in 33-25114 and Exhibit 4(c) to Current Report on Form 8-K dated September 26, 1990 in 1-6140).
*4(e)	Rights Agreement between Dillard's, Inc. and Registrar and Transfer Company, as Rights Agent (Exhibit 4.1 to Form 8-K dated as of March 2, 2002 in 1-6140).
**10(a)	Retirement Contract of William Dillard dated March 8, 1997 (Exhibit 10(a) to Form 10-K for the fiscal year ended February 1, 1997 in 1-6140).
**10(b)	1998 Incentive and Nonqualified Stock Option Plan (Exhibit 10(b) to Form 10-K for the fiscal year ended January 30, 1999 in 1-6140).
**10(c)	Amended and Restated Corporate Officers Non-Qualified Pension Plan (Exhibit 10.1 to Form 8-K dated as of November 17, 2007 in 1-6140).
**10(d)	Senior Management Cash Bonus Plan (Exhibit 10(d) to Form 10-K for the fiscal year ended January 28, 1995 in 1-6140).
**10(e)	2000 Incentive and Nonqualified Stock Option Plan (Exhibit 10(e) to Form 10-K for the fiscal year ended February 3, 2001 in 1-6140).
*10(f)	Second Amendment to Amended and Restated Credit Agreement among Dillard's, Inc. and JPMorgan Chase Bank (Exhibit 10 to Form 8-K dated June 3, 2005 in 1-6140).
*10(g)	Purchase, Sale and Servicing Transfer Agreement among GE Capital Consumer Card Co., General Electric Capital Corporation, Dillards, Inc. and Dillard National Bank (Exhibit 2.1 to Form 8-K dated as of August 12, 2004 in 1-6140).
*10(h)	Private Label Credit Card Program Agreement between Dillards, Inc. and GE Capital Consumer Card Co. (Exhibit 10.1 to Form 8-K dated as of August 12, 2004 in 1-6140).
*10(i)	Third Amendment to Amended and Restated Credit Agreement between Dillard's, Inc. and JPMorgan Chase Bank, N.A. as agent for a syndicate of lenders (Exhibit 10.1 to Form 8-K dated June 12, 2006 in File No. 1-6140).
*10(j)	Fourth Amendment to Amended and Restated Credit Agreement between Dillard's, Inc. and JPMorgan Chase Bank, N.A. as agent for a syndicate of lenders (Exhibit 10.2 to Form 8-K dated June 12, 2006 in File No. 1-6140).
*10(k)	Fifth Amendment to Amended and Restated Credit Agreement between Dillard's, Inc. and JPMorgan Chase Bank, N.A. as agent for a syndicate of lenders (Exhibit 10.1 to Form 8-K dated May 4, 2007 in File No. 1-6140).

<u>Number</u>	<u>Description</u>
12	Statement re: Computation of Ratio of Earnings to Fixed Charges.
21	Subsidiaries of Registrant.
23	Consent of Independent Registered Public Accounting Firm.
31(a)	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31(b)	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32(a)	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
32(b)	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

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\* Incorporated by reference as indicated.

\*\* A management contract or compensatory plan or arrangement required to be filed as an exhibit to this report pursuant to Item 14(c) of Form 10-K.







**board of directors**

Robert C. Connor ~ *Investments ~ Dallas, Texas*  
 Drue Corbusier ~ *Executive Vice President of Dillard's, Inc.*  
 Will D. Davis ~ *Partner with Heath, Davis & McCalla, Attorneys ~ Austin, Texas*  
 Alex Dillard ~ *President of Dillard's, Inc.*  
 Mike Dillard ~ *Executive Vice President of Dillard's, Inc.*  
 William Dillard, II ~ *Chairman of the Board & Chief Executive Officer of Dillard's, Inc.*  
 James I. Freeman ~ *Senior Vice President & Chief Financial Officer of Dillard's, Inc.*  
 John Paul Hammerschmidt ~ *Retired Member of Congress ~ Harrison, Arkansas*  
 Peter R. Johnson ~ *Chairman & Chief Executive Officer of PRJ Holdings, Inc. ~ San Francisco, California*  
 Warren A. Stephens ~ *President & Chief Executive Officer of Stephens Inc., Co-Chairman of SF Holding Corp. ~ Little Rock, Arkansas*  
 William H. Sutton ~ *Of Counsel, Friday, Eldredge & Clark, Attorneys ~ Little Rock, Arkansas*  
 J.C. Watts, Jr. ~ *Former Member of Congress & Chairman of J.C. Watts Companies ~ Washington, D.C.*

**corporate organization**

William Dillard, II ~ *Chief Executive Officer*  
 Alex Dillard ~ *President*  
 Mike Dillard ~ *Executive Vice President*  
 Drue Corbusier ~ *Executive Vice President*  
 James I. Freeman ~ *Senior Vice President & Chief Financial Officer*  
 Paul J. Schroeder, Jr. ~ *Vice President & General Counsel*

**vice presidents**

Tony Bolte	Michael E. Price
Kent Burnett	Christine Rowell
James W. Cherry, Jr.	Sidney A. Sanders
Randal L. Hankins	Burt Squires
William L. Holder, Jr.	Phillip R. Watts
Chris Johnson	Kent Wiley
Denise Mahaffy	Richard B. Willey
Steven K. Nelson	Sherrill E. Wise

**corporate merchandising product development****Vice Presidents, Merchandising:**

Joseph P. Brennan  
 Neil Christensen  
 William T. Dillard, III  
 Christine A. Ferrari  
 Mike McNiff  
 Terry Smith  
 James D. Stockman  
 Lloyd Keith Tidmore

**Vice Presidents:**

Les Chandler  
 Gianni Duarte  
 Ann Franzke  
 Richard Moore  
 Kay White

**regional vice presidents – merchandising****Presidents, Regional Merchandising:**

Drue Corbusier  
 Mike Dillard  
 Robin Sanderford  
 Julie A. Taylor  
 David Terry

**General Merchandise Managers:**

Lynn Conner  
 Mark Killingsworth  
 Jeff Menn  
 Anthony Menzie  
 Lisa M. Roby  
 Sandra Steinberg  
 Bob Thompson  
 Tom Ward  
 Keith White  
 Ronald Wiggins

**regional vice presidents – stores**

W.R. Appleby, II	William H. Hite
Tom Bolin	Dan W. Jensen
Larry Cailteux	Mike Litchford
Debra Dumas	Brant Musgrave
Mark Gastman	Zeina T. Nassar
Walter C. Grammer	Grizelda Reeder
Marva Harrell	Linda Sholtis-Tucker
Gene D. Heil	Alan Steinberg

# Dillard's

Dillard's, Inc. ranks among the nation's largest fashion apparel and home furnishings retailers with annual revenues exceeding \$7.3 billion. The Company focuses on delivering maximum fashion and value to its shoppers by offering compelling apparel and home selections complemented by exceptional customer care. Dillard's stores offer a broad selection of merchandise and feature products from both national and exclusive brand sources. The Company operates 326 Dillard's locations spanning 29 states, all with one nameplate — Dillard's.

## financial and other information

Copies of financial documents and other company information such as Dillard's, Inc. reports on Form 10-K and 10-Q and other reports filed with the Securities and Exchange Commission are available by contacting:

Dillard's, Inc.  
Investor Relations  
1600 Cantrell Road  
Little Rock, Arkansas 72201  
501.376.5544  
E-mail: [investor.relations@dillards.com](mailto:investor.relations@dillards.com)

Financial reports, press releases and other Company information are available on the Dillard's, Inc. Web site: [www.dillards.com](http://www.dillards.com)

Individuals or securities analysts with questions regarding Dillard's, Inc. may contact:

Julie J. Bull  
Director of Investor Relations  
1600 Cantrell Road  
Little Rock, Arkansas 72201  
Telephone: 501.376.5965  
Fax: 501.376.5917  
E-mail: [julie.bull@dillards.com](mailto:julie.bull@dillards.com)

## transfer agent and registrar

Registered shareholders should address communications regarding address changes, lost certificates, and other administrative matters to the Company's Transfer Agent and Registrar:

Registrar and Transfer Company  
10 Commerce Drive  
Cranford, New Jersey 07016-3572  
Telephone: 800.368.5948  
E-mail: [info@rtco.com](mailto:info@rtco.com)  
Web site: [www.rtco.com](http://www.rtco.com)

Please refer to Dillard's, Inc. on all correspondence and have available your name as printed on your stock certificate, your Social Security number, your address and phone number.

## corporate headquarters

1600 Cantrell Road  
Little Rock, Arkansas 72201

## mailing address

Post Office Box 486  
Little Rock, Arkansas 72203  
Telephone: 501.376.5200  
Fax: 501.376.5917

## listing

New York Stock Exchange,  
Ticker Symbol "DDS"

## on the cover

The look, feel and craftsmanship of "Real Luxuries" are shown in this handbag by David and Scotti and featured in "Dillard's – The Style of Your Life."

